89-1813

No._____

In The

Supreme Court of the United States

October Term, 1990

HARRY G. JOHN, as a Director and Trustee of De RANCE, Inc.,

Petitioner,

vs.

ERICA P. JOHN, as an Officer and Director of De RANCE, INC., a Wisconsin Non-Stock, Non-profit Corporation, and DONALD A. GALLAGHER, as an Officer, Director and Trustee of De RANCE, INC.,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF WISCONSIN

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QUESTIONS PRESENTED FOR REVIEW

1. Did state court proceedings which ousted petitioner from his positions as Trustee and Director of a philanthropic foundation which he had founded deny the petitioner due process of law by (1) denying petitioner trial by jury, (2) violating the doctrine of corporate neutrality, and (3) ignoring expert evidence introduced including evidence in support of the petitioner's special prerogative as the founder?

2. Should the Seventh Amendment to the Constitution of the United States apply to the states through the Fourteenth Amendment to the Constitution of the United States?

3. Did the action against the petitioner impair and contravene petitioner's rights to the free exercise of religion under the First Amendment to the Constitution of the United States?

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF WISCONSIN

Petitioner prays that a writ of certiorari issue to review the decision of the Court of Appeals of Wisconsin dated November 24, 1989 and the Order of the Supreme Court of Wisconsin dated February 20, 1990 by which the decision of the Court of Appeals of Wisconsin becomes the final decision of the State of Wisconsin.

OPINIONS BELOW

The Opinion of the Court of Appeals of Wisconsin is set out in the Appendix, pp. 2-20.

The Order of the Supreme Court of Wisconsin denying the Petition for Review is set out in the Appendix, p. 1.

JURISDICTION

Jurisdiction of this Court is invoked under 28 U.S.C. § 1257.

The order of the Wisconsin Supreme Court was entered on February 20, 1990 and the decision of the Court of Appeals of Wisconsin made final by the order of the Wisconsin Supreme Court was decided on November 24, 1989 and is reported at 153 Wis. 2d 343.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

First Amendment to the United States Constitution:

> "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances."

Seventh Amendment to the United States Constitution:

> "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law."

Fourteenth Amendment to the United States Constitution:

> "All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

Article I, Section 5 of the Wisconsin Constitution:

"**Trial by jury; verdict in civil cases.** SECTION 5. [As amended Nov. 1922] The right of trial by jury shall remain inviolate, and shall extend to all cases at law without regard to the amount in controversy; but a jury trial may be waived by the parties in all cases in the manner prescribed by law. Provided, however, that the legislature may, from time to time, by statute provide that a valid verdict, in civil cases, may be based on the votes of a specified number of the jury, not less than five-sixths thereof."

Wisconsin Statute 776.32(4):

"**Jurisdiction.** Courts shall have jurisdiction over directors, managers, trustees and other officers of corporations:

(4) To remove any such director, trustee or officer from the office upon proof or conviction of gross misconduct."

STATEMENT OF THE CASE

Harry John was born the heir to part of the Miller Brewing Company holdings. The Miller Brewing Company of Milwaukee, Wisconsin was founded by Mr. John's grandfather, Frederick E. Miller, in 1855. In 1946 Harry John created the De Rance Foundation for the express purpose of furnishing financial support to contemplative religious orders of the Roman Catholic Church. The Foundation took its name from the founder of the Trappist Order, Armand-Jean de Rance.

At its inception Harry John funded De Rance with dividends from his brewery stockholdings which were then in trust. Upon termination of the trust Mr. John donated the stock to De Rance in a series of gifts in 1952, 1953 and 1955. At the time of those transfers the holdings were worth Fourteen Million Dollars ($14,000,000.00) and constituted nearly 50% of the shares of the Miller Brewing Company. In 1970 De Rance sold the stock to Phillip Morris Company for Ninety-Seven Million Dollars ($97,000,000.00) Thereupon becoming the largest foundation in the world devoted to support of endeavors involving the Roman Catholic Church.

The Board of Directors of De Rance consisted of Mr. Harry John, his wife, Erica John, and Mr. John's long-time friend, Donald Gallagher. Mr. Gallagher and Mr. John were also the only trustees of the Foundation. Between 1970 and 1984 De Rance made grants of over One Hundred Twenty-Five Million Dollars ($125,000,000.00) to various charities throughout the world. The majority of the beneficiaries of the grants were organizations or individuals affiliated with or involved with the Roman Catholic Church. Despite the grants made, by 1983 the remaining assets of De Rance were approximately One Hundred Eighty-Eight Million Dollars ($188,000,000.00).

Sometime in September of 1984 Archbishop Pio Laghi, the ambassador from the Vatican to the United States, summoned Donald Gallagher and Erica John[1] to his diplomatic offices and residence in Washington, D.C. and advised Mr. Gallagher and Mrs. John to commence civil litigation against Harry John to oust him from his position with the De Rance Foundation.[2] On October 5, 1984 a civil action was commenced by Donald Gallagher and Erica John against Harry John in the Circuit Court of Milwaukee County, Wisconsin and at the commencement of the action an ex parte order was obtained removing Mr. John from his position as Director and Trustee of the Foundation. Mr. Gallagher and Mrs. John purported to proceed under §776.32(4) of the Wisconsin Statutes and alleged that Harry John was guilty of gross misconduct in mis-management and waste of the assets of the Foundation. Trial of the case was held in the Circuit Court of Milwaukee County between April 14, 1986 and August 20, 1986.

Prior to trial, during trial, and upon subsequent appeal the defendant Harry John argued **inter alia** that he was entitled to trial by jury, that his rights to the free exercise of his religion

1 The impact on Erica John was so telling that she claimed to have felt compelled to sue "under pain of grievous sin." (Brennan, App. 62,63)

2 A prominent Roman Catholic Layman, Peter Grace, ultimately at the behest of Archbishop Pio Laghi became involved in the management of De Rance after Mr. John's ouster.

were impaired or contravened by the proceedings and that he was denied due process of law. On August 21, 1986, the trial court rendered its decision holding on behalf of the plaintiffs and against defendant Harry John and ordering Mr. John's permanent ouster from his positions as the Director and Trustee of the De Rance Foundation. Subsequent thereto the trial judge enlarged his holding to enter judgment against Mr. John for over One Million Dollars ($1,000,000.00) for "equitable disgorgement."[3] Judgment on these holdings was entered by the trial court on December 21, 1987. An appeal was duly pursued to the Wisconsin Court of Appeals, District I, and the decision affirming the trial court was entered by the Court of Appeals of Wisconsin on November 24, 1989. (App., pp.2-20). A Petition for Review was filed with the Wisconsin Supreme Court and that Petition was denied on February 20, 1990. (App., p.1.) From the denial of the Petition for Review of the Wisconsin Supreme Court this Petition for Certiorari has been brought.

REASONS FOR GRANTING THE WRIT

I.

THE CIVIL PROCEEDINGS IN THE STATE OF WISCONSIN BY WHICH THE PETITIONER WAS OUSTED FROM HIS POSITIONS AS TRUSTEE AND DIRECTOR OF THE PHILANTHROPIC FOUNDATION WHICH HE CREATED WERE REPLETE WITH DUE PROCESS VIOLATIONS.

What happened to Harry John is unparalleled and unprecedented in the legal annals of the United States. In a civil context the circumstances of the prosecution of Harry John should shock the conscience of the Court as the circumstances in **Rochin v. California**, 342 US 165 (1952) shocked the conscience of the Court in the criminal law context.

3 This claim had not been included in the Complaint, Amended Complaint, nor adverted to during the entire trial and was not itemized until after the decision.

It is not hyperbole to say that no one has been so seriously injured by the interlacing of due process violations in a civil case as the petitioner has been in the case at bar.

The denial of due process is derived in the case at bar from the totality of the facts surrounding the trial held in the Circuit Court of Milwaukee County between April 14, 1986 and August 20, 1986. Although the denial to the petitioner of trial by jury (see § II **infra**) is one of the more blatant due process violations there are many others of great significance.

The proceedings had been stimulated if not directed by an ambassador of a foreign government whose inappropriate intervention into the internal domestic affairs of a citizen of the United States was brought to the attention of the trial court and - as with virtually every defensive matter brought to the Court's attention blithely dismissed by the trial judge. The uncontradicted expert testimony of a former ambassador from the United States to Mexico (see Appendix, pp. 51-60) was shunted aside and totally dismissed as the most "off the wall argument" that the trial judge had heard in 13 years on the bench. (App., p. 60)

In order to fund the lawsuit against the petitioner the respondents - who as individuals were proceeding as officers and directors of De Rance, Inc. - were allowed to fund their case with unlimited access to the corporate assets of De Rance, Inc. in excess of Five Million Dollars ($5,000,000.00). This flagrant violation of fundamental concepts of fairness and corporate neutrality was also blithely pushed aside by the trial court and superficially analyzed and affirmed by the Court of Appeals. Despite repeated motions and protestations about this inequity the trial court extended to the petitioner the pittance of a secured loan from the Foundation of a mere Twenty-Five Thousand Dollars ($25,000.00) to finance his defense.

In like fashion the trial court and the Court of Appeals disregarded as irrelevant the claims that the actions against the petitioner impaired the free exercise of his religion under the First Amendment to the Constitution of the United States. (See Section III **infra.**) The anomaly of this holding is that the trial court on the one hand sanctioned the interference of the

Ambassador from the Vatican on the grounds that because the Foundation was so Roman Catholic centered it was perfectly natural for the Ambassador from the Vatican to have grave concern about the assets of this private Foundation (App., p.25) but, on the other hand held that the connection of the Foundation to the Roman Catholic Church was so tenuous and unproven[4] that it did not fall within the statutory exception for religious corporations. (App., pp.25-26) Such inconsisten and contradictory holdings marked the entire trial.

Despite the fact that trial by jury was denied on the basis that the proceedings were purely equitable - this in the face of a counterclaim alleging conspiracy on which the trial court ultimately made findings of fact (App., pp.24-26)-, in his final decision the trial judge found the petitioner guilty of federal tax evasion, securities fraud, and perjury. (App., pp. 45-51) Hardly the usual findings of fact in an equitable proceeding.

Elementary due process of law required impartiality on the part of the judge. That the trial judge was not impartial is apparent not only from perversity of the procedural holdings but in his revelation during the oral decision that he was a communicant of the Roman Catholic Church and had had prior knowledge of the defendant. (See Appendix, pp. 22-24, 29) This concealment of the religious identity of the judge and Ambassador and prior familiarity with the defendant and the Foundation should have disqualified the trial judge or at the very least should have been called to the attention of the parties **at the commencement of the proceedings.**

The clearest demonstration of the persuasion of the trial judge can be seen in his disregard of all of the expert testimony adduced on behalf of the petitioner during the trial. That

[4] The Foundation Corporate Headquarters by special dispensation contained a chapel where Mass was celebrated every weekday and the Blessed Sacrament housed on a permanent basis, 24 hours a day. This latter privilege is accorded only to entities affiliated with the Roman Catholic Church.

testimony included the foundation's money manager,[5] a professor of finance, a Hollywood producer, an expert on evangelical television, three distinguished anthropologists and the ranking expert on philanthropy and private foundations in the United States, Waldemar A. Nielsen. Selected abstracts of these experts' testimony is presented in the Appendix to show the flavor of their testimony. (Appendix, pp. 51-98) The trial judge contemptuously rejected the testimony in his decision and made it appear that these eminent witnesses were cranks or charlatans acknowledging only that witnesses Pick and Nielsen were of any significance. (App., p. 33) The trial judge viewed the anthropologist's testimony as "basically worthless" and made no comment whatsoever concerning the clear testimony of the Professor of Finance, Professor Zivney. (App., p.33) The cumulative effect of the testimony, of course, was to unequivocally demonstrate the historical prerogatives attending the founder of a philanthropic foundation - especially with respect to the concepts of waste of the foundation's assets and how that impacted on the concept of "gross misconduct" under § 776.32(4), Wis. Stats. By brushing the evidence aside as the trial judge did the core of the defense was avoided and indeed the Court of Appeals of Wisconsin in its decision makes no mention of that aspect of the case.

II

THE SUPREME COURT SHOULD TAKE THIS OPPORTUNITY TO HOLD THE SEVENTH AMENDMENT APPLICABLE TO THE SEVERAL STATES THROUGH THE FOURTEENTH AMENDMENT.

Wagner Company v. Lyndon, 262 U.S. 226, 435 S.Ct. 589, 67 L.Ed. 961 (1923) and **Walker v. Sauvinet**, 92 U.S. 90, 23 L.Ed. 678 (1876) are traditionally cited for the proposition that the Seventh Amendment right to trial by jury in a civil action is not applicable to the states under the due process clause of the Fourteenth Amendment.

5 Since the trial Mr. Astman has been recognized by the **New York Times** as the best money manager in the United States.

Re-examination of that principle would be appropriate because of the egregious circumstances that occurred in the case at bar and for the further reason that the State of Wisconsin has a constitutional provision affording the citizens of that state the right of trial by jury in a civil case. See Article I, § 5 of the Wisconsin Constitution. This is not a situation such as those found in **Walker** and **Wagner Company, supra** where there were state provisions expressly prohibiting jury trials in the particular circumstances found therein. Here the state statutory scheme was silent as to whether or not a jury was permitted. Under the circumstances where a citizen is divested of an important property interest (if not liberty interest, since he was expressly found to have violated federal criminal laws and a money judgment was entered against him in excess of One Million Dollars), see, e.g., **Tull v. United States**, 481 U.S. 412 (1987), **Beacon Theatres, Inc. v. Westover**, 359 U.S. 500 (1959), **Dairy Queen, Inc. v. Wood**, 369 U.S. 469 (1962), **Ross v. Bernhard**, 396 U.S. 531 (1970), it can well be said that it is time for the United States Supreme Court to apply the Seventh Amendment to the states.

> "What Blackstone d scribed as 'the glory of the English law' and 'the most transcendent privilege which any subject can enjoy,' 3 W. Blackstone, Commentaries *379, was crucial in the eyes of those who founded this country. The encroachment on civil jury trial by colonial administrators was a deeply devisive issue in the years just preceding the outbreak of hostilities between the colonies and England,' and all thirteen States reinstituted the right after hostilities ensued. Wolfram, The Constitutional History of the Seventh Amendment, 57 Minn. L.Rev. 639, 654-655 (1973). 'In fact, '[t]he right to trial by jury was probably the only one universally secured by the first American constitutions.' " **Id.** at 655 (quoting L. Levy, Freedom of Speech and Press in Early American History-Legacy of Suppression 281 (1963 reprint)). Fear of a federal government that has not guaranteed jury trial in civil cases, voiced first at the Philadelphia Convention in 1787 and regularly during the ratification debates, was the concern that precipitated the maelstrom over the need for a bill of rights in the United States Constitution. Wolfram, **supra**, at 657-660.

> This Court has long recognized the caliber of this right. In **Parsons v. Bedford**, 3 Pet. 433, 446 (1830), Justice Story stressed: 'The trial by jury is justly dear to the American people. It has always been an object of deep interest and solicitude, and every encroachment upon it has been watched with great jealousy.' Similarly, in **Jacob v. New York City**, 315 U.S. 752, 752-753 (1942), we said that '[t]he right of jury trial in civil cases at common law is a basic and fundamental feature of our system of federal jurisprudence...[a] right so fundamental and sacred to the citizen [that it] should be jealously guarded by the courts.'"

Chauffeurs, Teamsters & Helpers Local No. 391 v. Terry, _____U.S. _____, 58 L.W. 4345 at 4350-51 (U.S. Supreme Court March 20, 1990) [Brennan, J. concurring in part and concurring in the judgment.]

III.

THE PETITIONER'S FIRST AMENDMENT RIGHTS TO FREE EXERCISE OF HIS RELIGION WAS SIGNIFICANTLY IMPAIRED BY THE STATE ACTION.

The question of the First Amendment rights of the petitioner were framed in the Wisconsin courts in terms of the exclusion of religious corporations from inclusion in § 776.32. That argument was answered by neatly declaring that the De Rance Foundation was not actually a "religious corporation" in that its charitable activities were not solely confined to institutions or agencies of the Roman Catholic Church. (App., pp. 25-26) Such findings not only flew in the face of any reasonable interpretation of the facts, because in fact during the entire existence of the Foundation, the vast majority[6] of its grants went to fund entities of the Roman Catholic Church but also skirts the core issue of the petitioner's right to practice his religious beliefs by pursuing what had become the main venture -

6 Out of the thousands of grants but a handful were to organizations not affiliated with the Church.

so eminently in keeping with the purposes and ideals of the Foundation and with the specific admonitions of Vatican Council II - **Decree on the Means of Social Communications**, Dec., 1963, which was the source of dissatisfaction to the other directors - that was the establishment of a Roman Catholic television network. It was the establishment of that network and the expenses involved therein that stimulated the interest of Archbishop Pio Laghi and resulted in the commencement of the litigation against Harry John. Here it is ironic to note that it was a churchman - indeed the Ambassador from the Vatican to the United States - who was obviously desparately concerned about a church related matter. As the trial court observed this interest was supposedly understandable. (App., p. 25) It is in this context that the petitioner's claim of impairment of the free exercise of his religion should be considered, similar to the claims of the Amish that they are entitled to educate their children in an alternative school system. See **Wisconsin v. Yoder**, 406 U.S. 205 (1972).

What Harry John desired was to establish the presence of a television network devoted exclusively to the Roman Catholic Church as was strongly encouraged by Vatican Council II. How the accomplishment of that could be anything other than a direct exercise of religious belief is incomprehensible. As the expert witnesses, Nielsen, Jauregui, Simic, and Abrams indicated, it is and has been historically the prerogative of the philanthropic donor in such circumstances to completely exhaust his resources in pursuing such an endeavor the wishes of his co-directors and hierarchy of the particular church to the contrary notwithstanding. It is in this regard that the First Amendment rights of the petitioner were despoiled. Of course, he was not told that he could not practice his religion but he was told how and to what financial extent his Foundation could support a religious enterprise. He was prohibited and barred from pursuing that enterprise because others decided it was financially imprudent. Again, the fundamental nature of philanthropic foundations to expend substantial resources was ignored[7] It would be the

[7] In this regard, the petitioner presented evidence that was totally disregarded that 1.) the enterprise was going to succeed financially and it was fully expected that scheduled telethons and direct mail would soon cause the television enterprise to become self-supporting and 2.) the other directors approved every expenditure made.

heighth of absurdity to arbitrarily limit expenditures of philanthropic foundations. Expenditure of resources is the reason for their existence. The Roman Catholic trial judge was obviously just as "concerned" as Ambassador Pio Laghi that the resources of the De Rance Foundation not be exhausted in the attempt to present the message of the Roman Catholic Church via a television network. That "concern" prompted his violation of the petitioner's first amendment rights. He decided to pre-empt the founder's wishes and strike at the fundamental principle that it is the founder who best understands the fundamental nature and purposes of the foundation he himself has established.

CONCLUSION

For the foregoing reasons the Petition for Certiorari should be granted.

Respectfully submitted,

SUTTON & KELLY

By: Robert E. Sutton
Walter F. Kelly

Attorneys for Petitioner

APPENDIX A

OPINION OF SUPREME COURT OF WISCONSIN

Office of the Clerk
SUPREME COURT
STATE OF WISCONSIN

Hon. Michael J. Barron
Milwaukee County Circuit Court
901 N. 9th St., Rm. 403
Milwaukee, WI 53233

Madison, February 20, 1990

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The Court today announced an order in your case as follows:

No. 88-1507 **Erica P. John, et al. v. Harry G. John**
L.C.#650-555

A petition for review pursuant to sec. 808.10, Stats., having been filed on behalf of defendant-appellant-petitioner Harry G. John, as a Director and Trustee of DeRance, Inc., and considered by the Court,

IT IS ORDERED that the petition for review is denied,with $50 costs.

MARILYN L. GRAVES
Clerk of Supreme Court.

APPENDIX B

OPINION OF COURT OF APPEALS OF WISCONSIN

No. 88-1507

State of Wisconsin — In Court of Appeals, District I

Erica P. JOHN, as an officer and director of De Rance, Inc., Wisconsin non-stock, non-profit corporation, and Donald A. Gallagher, as an officer, director and trustee of De Rance, Inc., *Plaintiffs-Respondents,*

v.

Harry G. JOHN, as a director and trustee of De Rance, Inc., *Defendant-Appellant.* †

APPEAL from a judgment of the circuit court for Milwaukee county: MICHAEL J. BARRON, Judge. *Affirmed.*

For the defendant-appellant the cause was submitted on the briefs of *Pappas & Stewart,* by *David C. Pappas,* of Madison.

For the plaintiffs-respondents the cause was submitted on the briefs of *O'Neil, Cannon & Hollman, S.C.,* of Milwaukee, and *Cannon & Dunphy, S.C.,* of Milwaukee, by *Thomas G. Cannon.*

Before Sullivan, Fine, and Brown, JJ.

SULLIVAN, J. Harry G. John appeals from a judgment permanently enjoining him from serving as a director and trustee of De Rance, Inc. and ordering him to pay equitable disgorgement of $1,171,418 plus interest to De Rance. John raises eleven issues on appeal. He argues that:

† Petition to review pending.

(1) the trial court lacked jurisdiction to remove him as a director and trustee of De Rance because De Rance is a religious corporation and that statutes authorizing removal of corporate directors and trustees do not grant jurisdiction in this case;

(2) the trial court had no other jurisdictional basis to command his removal;

(3) the trial court's exercise of jurisdiction violated his rights to religious freedom under the state and federal constitutions;

(4) the trial court abused its discretion by failing to consider less restrictive sanctions than his removal;

(5) the trial court's findings of gross misconduct were clearly erroneous and do not support the sanction of his removal;

(6) the trial court's findings that John received notice of the action and that the plaintiffs, Erica P. John and David A. Gallagher, had authority to commence this action were clearly erroneous;

(7) the trial court erred under statutory and common law in denying him indemnification for the costs of his defense;

(8) the trial court abused its discretion in permitting Gallagher and Mrs. John to finance their litigation expenses with De Rance funds while not extending the same privilege to Mr. John;

(9) the trial court abused its discretion in granting Gallagher and Mrs. John leave to amend their complaint;

(10) the trial court violated John's due process and equal protection rights by denying him a jury trial; and,

(11) the trial court violated John's federal due process rights by granting equitable disgorgement, a remedy that the plaintiffs did not request until several weeks after conclusion of the trial.

We conclude that the trial court had jurisdiction over this matter and that its exercise of jurisdiction did not violate John's constitutional rights to religious freedom; that the trial court properly determined that John's conduct constituted "gross misconduct" and did not abuse its discretion in imposing sanctions; and, that John was deprived of no other substantial

right resulting in prejudicial error. Therefore, we affirm the decision of the trial court.

After a lengthy trial, the trial court filed comprehensive findings of fact. They number 203 and cover 93 pages of a record that approximates 23,000 pages. For the most part, they are undisputed on appeal and trace John's activities as treasurer, chief financial officer, director, and trustee for De Rance and its investment activities. The court found that John had committed gross misconduct and breached his fiduciary duties as a director and trustee of De Rance. In specific findings of fact too comprehensive to fully detail in the context of this opinion, the trial court determined that John had engaged in a pervasive pattern of abuse of office including securities fraud, tax fraud, perjury, self-dealing, conflicts of interest, corporate fraud, lying to the board of directors, breach of fiduciary duties, deception and disobedience of the board of directors, waste and mismanagement of De Rance and its investments in Santa Fe Communications, Inc. (Santa Fe) and HBI Acquisition Corp. (HBIAC) including extensive investments in fraudulent deep sea treasure hunts.

De Rance, a non-stock corporation organized under Chapter 181, Stats., was established in 1946. John funded it in the early 1950's by three deeds of gift valued at $14 million, consisting of his inherited stock in the Miller Brewing Company. De Rance was organized to provide financial support for religious, charitable and educational causes. Until 1970, De Rance grants were paid from Miller stock dividends. In 1970 De Rance sold its 47% equity position in Miller to the Philip Morris Company for $97 million. From 1970 to 1984, grants totaled $125 million and were made principally, but not exclusively, to Roman Catholic charities and institutions. The market value of De Rance's assets was $188 million in 1983.

From its creation until September of 1982, De Rance operated exclusively as a grant-making organization. In September of 1982, John incorporated Santa Fe as a non-profit, non-stock corporation under Chapter 181, Stats. It was organized for the purpose of producing and broadcasting radio, television, and cinema programs and publishing printed matter of a religious and educational nature consistent with the teachings of the Holy See. Through Santa Fe, John hoped to establish a national television and satellite communications

empire. To that end, John caused De Rance, Santa Fe, and HBIAC to acquire substantial interests in television and radio stations and to establish several production facilities with all funds provided by De Rance. The trial court found that John's mismanagement caused De Rance to accumulate more than $86 million in unnecessary and wasteful expenses related to these investments.

Until October of 1984, John was the sole donor, trustee, chairman of the board of directors, president and chief executive officer, and treasurer and chief financial officer of De Rance. The trial court characterized John as De Rance's "dominant authority":

> Defendant was the dominant authority in controlling the course of events at De Rance, Santa Fe, and HBIAC by virtue of (a) his original contributions of Miller Brewery Co. stock to De Rance, (b) his holding the key executive and financial positions in all three entities, (c) his domineering personality, and (d) his secretive and manipulative manner of operating these entities in such a way as to exclude all but himself from making the critical decisions, and the acquiescing personalities of both plaintiffs.

As of October, 1984, Erica John was an officer and member of the board of directors of De Rance, and Donald Gallagher was an officer, director and trustee of De Rance.

The procedural history of the case is succinctly set forth in the trial court's findings of fact:

> On October 5, 1984, defendant was suspended as an officer, director and trustee of De Rance by an exparte order of this Court upon a showing of an appearance of abuse of his trust pursuant to Section 776.32(3), Wis. Stats. On October 15, 1984, defendant was removed from his positions as president and treasurer of De Rance by action of the board of directors of De Rance. This removal was ratified and confirmed at a special meeting of the board of directors of De Rance on January 2, 1985. Plaintiffs used proper corporate procedures to remove defendant from his positions as president and treasurer. Defendant's suspension as a director and trustee of De Rance was continued through the trial by virtue of a stipulation for the entry of a

preliminary injunction in this action which was signed by the Court on February 11, 1985. Defendant was permanently removed from his positions as trustee and director of De Rance by decision of this court on August 21, 1986.

Judgment was entered on December 21, 1987.

We will set forth additional facts as needed, and, at the risk of being mistaken for a member of the species *Ursus Saltandus*, we will principally address John's eleven issues *seriatim*. *See State v. Waste Management of Wisconsin, Inc.*, 81 Wis. 2d 555, 564, 261 N.W.2d 147, 151 (1978).

JURISDICTIONAL ISSUES

The trial concluded that its exercise of jurisdiction in this case was proper. It stated: "The Court possesses inherent equity jurisdiction and statutory jurisdiction pursuant to section 776.32(4) of the Wisconsin Statutes over the parties and subject matter of this action." However, John contends that De Rance is a religious corporation, free of the requirements and constraints that apply to commercial corporations, and that it is not subject to state subject-matter civil jurisdiction.

John contends that sec. 776.32, Stats., does not vest the trial court with jurisdiction over him, and, alternatively, that the court has no inherent equitable power in this matter.[1] Subsections (3) and (4) of that statute vest the court with authority to suspend corporate officers and directors on appearance of abuse of trust and to remove them "upon proof or conviction of gross misconduct." John relies on sec. 776.46, Stats., which expressly excludes "religious corporations"

[1]Section 776.32(3) and (4), Stats., provides:

776.32 Jurisdiction. Courts shall have jurisdiction over directors, managers, trustees and other officers of corporations:

. . ..

(3) To suspend any director, trustee or officer from exercising the office on appearance of abuse of his or her trust.

(4) To remove any such director, trustee or officer from the office upon proof or conviction of gross misconduct.

from the provisions of Chapter 776, Stats.[2] He argues that De Rance qualifies as a "religious corporation" under either Chapter 187, Stats., or sec. 182.030, Stats.[3]

[1]

An action under sec. 776.32 is essentially equitable in nature. *McGivern v. Amasa Lumber Co.*, 77 Wis 2d 241, 257, 252 N.W.2d 371, 378 (1977) (discussing the predecessor to sec. 776.32). The standard of review in equity cases is whether the findings of the trial court are against the great weight and clear preponderance of the evidence. *W.H. Pugh Coal Co. v. State*, 105 Wis. 2d 123, 127, 312 N.W.2d 856, 858 (Ct. App. 1981).[4]

The trial court found:

> De Rance is a non-profit, non-stock corporation organized under the Wisconsin Non-Stock Corporation Act, Wis. Stats. Ch. 181 . . ..
>
> De Rance is not a religious corporation within the meaning of sections 182.030, 776.46, or Chapter 187 of the Wisconsin Statutes. Rather, it is a charitable corporation which has made a wide variety of grants to many non-Catholic or nondenominational organizations.

[2]Section 776.46, Stats., provides:

> **776.46 What corporations not affected.** The provisions of this chapter shall not extend to any incorporated library or lyceum society, to any religious corporation or any incorporated academy or select school, nor to the proprietors of any burying ground incorporated under the laws of this state.

[3]Chapter 187, Stats., is entitled "Religious Societies." Section 182.030, Stats., provides:

> **182.030 Corporations having church affiliations.** Whenever any corporation shall be formed for the benefit of, or be in any manner connected with, any church or religious denomination or society, its articles of organization may provide that it shall be under the supervision and control of such church, denomination or society; and the officers or trustees be communicants thereof.

[4]This standard is essentially the same as the "clearly erroneous" standard set forth in sec. 805.17(2), Stats. *Noll v. Dimiceli's, Inc.*, 115 Wis. 2d 641,643, 340 N.W.2d 575, 577 (Ct. App. 1983).

This finding has ample evidentiary support. In De Rance's Articles of Incorporation, filed with the Secretary of State on October 18, 1946, the incorporators declared their intention to form a "corporation." The purposes of the corporation, recited in Article I, include the acquisition of funds for "religious, charitable and educational purposes." The declared charitable objectives include not only gifts to religious institutions, but to the care of the sick, aged, and helpless. Articles of Amendment dated August 1, 1960 amended Article I by specifying, *inter alia*, that De Rance's charitable endeavors need not be confined to institutions or agencies of the Roman Catholic Church. The amendment also deleted a provision which required one-half of the advisory board to be members of the clergy. A further amendment, dated September 23, 1980, prefatorily stated: "The Articles of Amendment of the Articles of Incorporation of De Rance, Inc., a Wisconsin corporation *subject to the provisions of Chapter 181 of the Wisconsin Statutes* . . .." [Emphasis added.] Thus, De Rance's Articles of Incorporation support the trial court's finding that De Rance is a Chapter 181 corporation.

In addition, De Rance's grant activities demonstrate that its giving is not limited to the Roman Catholic Church. In recent years, grants exceeding $5 million were made to secular or non-Roman Catholic charities including the United Way, Concordia College, the Medical College of Wisconsin, the Easter Seal Society, and many others.

The trial court's finding that De Rance is not a Chapter 187 religious society is not clearly erroneous. Reference to sec. 187.12, Stats., dispels any notion that De Rance was incorporated as a religious society. *See generally* sec. 187.12, Stats. (governing incorporation of Roman Catholic congregations). De Rance is subject to no diocesan authority whatsoever. John's reliance on sec. 182.030, Stats., is also inappropriate. De Rance's Articles of Incorporation and Amendments nowhere subject it to the supervision or control of any religious society, nor do they indicate that it was formed for the benefit of any religious society.[5]

[5]*See*, sec. 182.030, Stats., *supra* note 3.

[2]

Because the trial court's finding that De Rance is a charitable corporation under Chapter 181, Stats., is not clearly erroneous, we conclude that the trial court had jurisdiction pursuant to sec. 776.32(4), Stats., to remove John for gross misconduct. It is unnecessary for us to determine whether the trial court had superintending equity jurisdiction to effect John's removal. *See Gross v. Hoffman*, 227 Wis. 296,300, 277 N.W. 663, 665 (1938).[6]

JOHN'S FREE EXERCISE OF RELIGION

John argues that the injunction removing him as a director and trustee of De Rance interfered with his constitutional right to free exercise of religion.[7] He argues that no overriding state interest required his removal and that the trial court abused its discretion by failing to consider sanctions less drastic than removal.

[6]John's reliance on *Green Scapular Crusade, Inc. v. Town of Palmyra*, 118 Wis. 2d 135, 345 N.W.2d 523 (Ct. App. 1984), is misplaced. The issue before the court in that case was whether a corporation organized under Chapter 181 was a "religious association" entitled to a property tax exemption under sec. 70.11(4), Stats. Although we determined that a "religious corporation" could be organized under Chapter 181, our decision was not made in the context of sec. 776.46, nor did it involve the critical jurisdictional issues presented by the case at hand.

[7]Wis. Const. art. I, sec. 18 provides:

> **Freedom of worship; liberty of conscience; state religion; public funds.** SECTION 18. The right of every person to worship Almighty God according to the dictates of conscience shall never be infringed; nor shall any person be compelled to attend, erect or support any place of worship, or to maintain any ministry, without consent; nor shall any control of, or interference with, the rights of conscience be permitted, or any preference be given by law to any religious establishments or modes of worship; nor shall any money be drawn from the treasury for the benefit of religious societies, or religious or theological seminaries.

U.S. Const. amend. I provides in part: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof. . .."

[3]

This issue requires us to apply the U.S. and Wisconsin constitutions to a group of undisputed facts. It is a question of constitutional interpretation which we decide *de novo*. *See State v. Beno*, 116 Wis. 2d 122, 136-37, 341 N.W.2d 668, 674 (1984).

[4]

Essentially, John claims that the trial court orders violated his constitutional right to freely exercise his religion, Roman Catholicism. Governmental action may be unconstitutional if it imposes a burden on the free exercise of religion. *State v. Horn*, 126 Wis. 2d 447, 454, 377 N.W.2d 176, 179 (Ct. App. 1985), *aff'd*, 139 Wis. 2d 473, 407 N.W.2d 854 (1987). However, we reject this argument because the judgment only brought to conclusion John's relationship with De Rance.

[5]

The trial court's injunction and other orders did not impose any burden on John's free exercise of religion. John, in his appellate brief, frequently and emphatically pronounced his Roman Catholic religious preference. However, he fails to identify how the court's orders hamper his practice of religion. His fall from grace as an officer, director, and trustee of De Rance does not affect his ability to practice Roman Catholicism. He can be as faithful to the church with or without these offices. John points to no cardinal principle of Roman Catholicism that is affected by the judgment. The orders of the trial court are neither an affront to John's beliefs nor an assault upon his practice of those beliefs.

JOHN'S REMOVAL: GROSS MISCONDUCT

John argues that the trial court's finding of his gross misconduct is clearly erroneous because: (1) his business judgment, however imprudent, was essentially honest; and (2) Erica John and Gallagher waived any objection to his transactions because they acquiesced to them.

[6,7]

Section 776.32(4), Stats., vested the trial court with the power to remove a director or officer upon proof of gross misconduct. However, the term "gross misconduct" is not defined in the statutes. The Wisconsin Supreme Court has

declared that as a well-established rule courts will not interfere in corporate affairs in the absence of allegations clearly disclosing abuse of power by the corporate officers, bad faith, willful abuse of discretion, or positive fraud. *Thauer v. Gaebler*, 202 Wis. 296, 301-02, 232 N.W.2d 561, 563 (1930) (shareholder suit to recover gratuity paid to corporate officer). We conclude that the term "gross misconduct" found in sec. 776.32(4), Stats., embraces the concepts of an officer's abuse of power, bad faith, willful abuse of discretion, or positive fraud. Gross misconduct contains the element of intentional wrongdoing or failure to act consistently with the officer's duty to the corporation. In this case, the findings of the trial court establish John's abuse of power, and, in some instances, his practice of positive fraud upon De Rance. Thus, his conduct may not be excused under the guise of "honest business judgment."[8]

John opened his personal account at the securities brokerage firm of Morgan, Olmstead, Kennedy and Gardner (MOKG) on June 7, 1977, the day before De Rance opened its account there. John's self-dealing included direct stock sales from his account to De Rance. In twenty-three transactions, the total sales equalled $802,875.53 The securities were placed in a De Rance account called "Fund E" and netted John a gain of $95,643. The Fund E portfolio consisted of thinly traded, nonliquid securities. The direct sale permitted John to cash out in a falling market.

[8]The principle behind the "business judgment rule" was discussed by Justice Wickhem in *Steven v. Hale-haas Corp.*, 249 Wis. 205, 23 N.W.2d 260 (1946):

> Assuming that the evidence and findings do not disclose situations outlined in the preceding two paragraphs (that is a corrupt bargain or corporate action so patently harmful to the corporation as to indicate an abuse of discretion), this court will not substitute its judgment for that of the board of directors and assume to appraise the wisdom of any corporate action. The business of a corporation is committed to its officers and directors, and if their actions are consistent with the exercise of honest discretion, the management of the corporation cannot be assumed by the court.

Id. at 221, 23 N.W.2d at 628.

In addition, John engaged in securities frauds called "market manipulation" and "front running." The parallel accounts at MOKG permitted him to take advantage of De Rance's purchasing power. Frequently John's securities purchases were followed by substantial purchases of the same securities by De Rance. This elevated the market price of those securities, allowing John to liquidate his position at a substantial gain. Called "front running," this type of securities fraud invariably resulted in gains to John substantially greater than De Rance's. John's relationship with the brokers and command of the parallel accounts were not divulged to Erica John and Gallagher.

[8]

Other trial court findings detailed false expense and travel vouchers presented to and paid by De Rance. The court also found that John had engaged in tax misrepresentation and invested substantial De Rance funds in fraudulent deep sea treasure expeditions. The findings establish breaches of John's fiduciary duty of care and loyalty and conflicts of interest. For the most part, these instances of gross misconduct were not gainsaid at trial. We affirm the trial court's finding of gross misconduct.

As a defense, John argues that Erica John and Gallagher acquiesced in these activities. The trial court rejected this argument by its finding, based on credible evidence not contrary to the great weight and clear preponderance of the evidence, that Gallagher and Erica John did not have knowledge of John's self-dealing, securities infractions, tax misrepresentations, voucher misstatements and other breaches of duty, much less acquiesce in or authorize them. Upon certain occasions they authorized John to proceed, but only after John misadvised or withheld information from them.

[9]

John complains that the trial court erred by not at least allowing him to continue as a De Rance trustee. John, however, violated his superintending duty as trustee when he tolerated his shortcomings as a director. The trial court did not abuse its discretion in removing John from both of his fiduciary positions when his gross misconduct in one position implicated the other. *See Hanson & Assoc. v. Farmers Coop Creamery Co.*, 403 F.2d 65, 70 (8th Cir. 1968) (evidence of gross mismanagement justi-

fies removal as director and voting trustee; citing Minn. Stat. Ann. sec. 316.03(3) and (4)).

NOTICE OF COMMENCEMENT OF THE ACTION; THE STIPULATION

[10]

John argues that Gallagher and Erica John lacked corporate authorization to bring and maintain this action. He bases this argument on section 181.20(1) Stats., which prescribes a minimum of three directors in a corporation.[9] However, no corporate authorization was required. Although this action was brought by the plaintiffs in their capacities as representatives of De Rance, it was not brought by De Rance, and, therefore, does not constitute a corporate act.

John cites no authority for the proposition that he should have received previous notice of any meeting to authorize suit for his removal. We decline to review the legal argument proffered by John because he cites no authority to support it. Rule 809.19(1)(e), Stats.; *see Racine Steel Castings v. Hardy*, 139 Wis. 2d 232, 240, 407 N.W.2d 299, 302 (Ct. App. 1987), *rev'd on other grounds*, 144 Wis. 2d 553, 426 N.W.2d 33 (1988).

John also argues that his attorneys lacked authority to enter a stipulation for entry of the February 11, 1985 injunction and that the trial court abused its discretion in refusing to grant him elief. Again John has supplied no legal authority for his position and accordingly we decline to address it. *Id.* Rule 809.19(1)(e), Stats., requires that the argument on each issue on appeal contain citations to authority. In addition, John has not demonstrated how he may have been prejudiced by the stipulation. *See Jax v. Jax*, 73 Wis 2d 572, 582, 243 N.W.2d 831, 837 (1976). Therefore, we find no error.

[9]Section 181.20(1), Stats., provides:

181.20 Number and election of directors. (1) The number of directors of a corporation shall not be less than 3. Subject to such limitation, the number of directors shall be fixed by or in the manner provided in the articles of incorporation, or, if the articles of incorporation so provide, by or in the manner provided in the bylaws.

INDEMNIFICATION—CORPORATE NEUTRALITY

The trial court approved a $25,000 loan to fund John's defense of this action. He contends that De Rance should have fully indemnified him for this expense. He argues that the court violated the principle of corporate neutrality by authorizing huge outlays to launch and support this action while simultaneously denying him all but a relatively small loan for his defense.

[11]

In its analysis of this issue, the trial court applied section 181.045, Stats. (1983-84).[10] Again, the facts relating to the indemnification and neutrality issues are either undisputed or have been determined by the trial court and are not contrary to the great weight and clear preponderance of the credible evidence. Application of the statute and related case law to these facts presents a legal issue which we decide without deference to the conclusions of the trial court. *Tenpas v. Dept. of Natural Resources*, 148 Wis. 2d 579, 582, 436 N.W.2d 297, 298 (1989).

[12]

John's claim for indemnification is defeated by section 181.045(1) and (3), Stats. (1983-84). As the trial court determined, John did not exercise good faith during the period in question and has not been successful on the merits. John not only failed in the defense of what he considered to be his

[10]Sections 181.045(1) and (3), Stats. (1983-84), provide in part:

> **181.045 Indemnification of officers, directors, employes and agents. (1)** A corporation may indemnify any person who was or is a party...to any suit threatened, pending or completed action, or proceeding, whether civil, criminal, administrative or investigative...if the person acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the corporation. . ..
>
> . . .
>
> (3) To the extent that a director, officer, employe or agent of a corporation has been successful on the merits or otherwise in defense of any action, suit, or proceeding referred to in sub. (1) or (2), or in defense of any claim, issue or matter therein, he shall be indemnified against expenses, including attorneys' fees, actually and reasonably incurred by him in connection therewith.

interest in De Rance, but his activities were inimical to De Rance's interest. He was entitled to no advance for defense costs, and, once losing, is entitled to no indemnification.[11]

Case law also supports this result. *Jesse v. Four Wheel Drive Auto Co.*, 177 Wis. 627, 189 N.W. 276 (1922), was a suit to compel corporate directors to reimburse the company for funds used to defend a minority shareholder suit against the directors and to enjoin further distributions. The supreme court affirmed the trial court's judgment ordering reimbursement and restraining future espenditures. The supreme court reasoned that the defense was to protect the director's rights and did not pertain to any interest of the company, and, therefore, the distributions were invalid. Addressing the shareholders' resolution which authorized the distributions the supreme court said: "From no standpoint, legal, equitable, or moral, can less than all the shareholders authorize the use of the funds of the corporation for purposes not germane to the business of the corporation." *Id.* at 634, 148 N.W. at 279.

[13]

John also relies on De Rance's By-Law Seventeen[12] which provides, *inter alia*, that De Rance will indemnify a party to a civil suit by reason of the fact that he is a De Rance officer or director. Such officer or director may recover expenses, including attorney fees, "actually and reasonably incurred in connection with such action... to the full extent *permitted under the law* . . . ." [Emphasis added.] Because secs. 181.045(1) and (3), Stats. (1983-84), conditioned indemnification upon an individual's good faith actions,and upon his or her success on the merits, John does not qualify as "*permitted under the law*." Therefore, the by-law does not provide John with a right to indemnification.

[11]*See* Note, *Corporations: Directors: Indemnification for Litigation Expenses*, 37 Cornell L.Q. 78, 19-80 (1951), "American jurisdictions universally hold that directors who are unsuccessful in their defense to civil actions based upon their misconduct are not entitled to reimbursement from the corporation for litigation expenses."

[12]The by-laws as amended through June 29, 1981.

[14]

In addition, De Rance had no duty to maintain a stance of corporate neutrality in this litigation. This suit was not purposed to protect or establish any personal interest of the plaintiffs. It was brought to abate John's continued depredation of De Rance. John's reliance on *Jesse v. Four Wheel Drive Auto Co.* fails because the directors there retained counsel to defend a suit against their personal account, rather than to defend any interest of the corporation. *See Jesse* at 629,634, 189 N.W. at 277, 278. Also, in *Kanneberg v. Evangelical Creed Congregation*, 146 Wis. 610, 131 N.W. 353 (1911), a religious corporation was required to pay attorney's fees incurred in good faith in defense of an action brought by a minority of the congregation, even though the defense ultimately failed. The supreme court stated: "A corporation has, inherently, by necessary implication, the right . . . to defend against judicial interference . . . and also authority to incur all the reasonable expense to that end, such as that for counsel and other ordinary expenses of litigation." *Id.* at 614-15, 131 N.W. at 354.

John cites no pertinent authority to establish his right to defense funds based on the doctrine of corporate neutrality. We decline to adopt John's position on the basis of the record before us.[13]

AMENDMENT TO THE COMPLAINT

John argues that the trial court erred by granting the plaintiffs leave to file an amended complaint a month before trial. *See* Section 802.09(1), Stats.[14] The original complaint, filed October 5, 1984, focused on John's activities concerning the Santa Fe television project and the treasure salvage endeavor. The amended complaint added new factual allegations.

[13]John cites *Solimine v. Hollander*, 129 N.J. Eq. 264, 19 A.2d 344 (N.J. Ch. 1941). It does not support his position. The New Jersey court held that a director who is a defendant in a shareholder's derivative suit is not entitled to advance payment of the costs of his defense, but once vindicated, he is entitled to reimbursement. *Id.* 19 A.2d at 348.

[14]The amended complaint and moving papers were filed on March 14, 1986. The trial court, after argument, granted the motion on March 24. Trial date had been set for April 14.

[15,16]

The standard of review for an order amending pleadings is the "abuse of discretion" standard. *Leciejewski v. Sedlak*, 110 Wis. 2d 337, 350, 329 N.W.2d 233,239 (Ct. App. 1982). In exercising its discretion, the trial court may not permit the amendment to unfairly deprive an adverse party of the opportunity to contest issues raised by the amendment. *Id.*, 110 Wis. 2d at 351, 329 N.W.2d at 240.

The trial court's findings of fact fully demonstrate its appropriate exercise of discretion. John himself, by various evasions, including failure to answer interrogatories and evasive answers at his deposition, contributed to the amended complaint's late filing. The court stated that new material alleged in the amendment was within John's knowledge and obviously did not prejudice his defense. He presented witnesses in defense against the amended complaint. Also, the court allowed John a three-week continuance at the close of the plaintiff's evidence to prepare his defense.

[17]

John does not argue that the amendment prejudiced his defense as to any particular issue. In fact, he contested all of them. The amendment sought no change in form of relief but added facts, all of which were within John's knowledge. We hold that the trial court did not abuse its discretion by granting leave to file the amended complaint.

JURY TRIAL

John contends that his federal and state due process and equal protection rights were violated because he was not accorded a jury trial. Again, John makes no citation to authority and we decline to address this subject. *See* Sec. 809.19(1)(e), Stats.; *Racine Steel Castings*, 139 Wis. 2d at 240, 407 N.W.2d at 302.

AMENDMENT: EQUITABLE DISGORGEMENT

John argues that the trial court erred by granting De Rance disgorgement in the sum of $1,171,097 because: (1) De Rance was never a party to the action; and (2) John's due process rights were violated in that he had no notice or opportunity to defend.

Whether De Rance was a party to this action is immaterial. John is the object of the court's judgment. Thus, the essential question is whether the trial court had jurisdiction over him. John does not dispute the court's personal jurisdiction. *See* sec. 801.05(8), Stats. The court also had subject-matter jurisdiction to order disgorgement under sec. 776.32(2), Stats.[15]

John argues that sec. 802.09(1) and (2), Stats., permitting amendments to conform to proof, requires a showing of either express or implied consent to trial of the issue, or no prejudice to the party. John asserts that he did not consent to the amendment and that it was prejudicial. He also argues that *res judicata* considerations would not bar De Rance could commence a new action for disgorgement, that such an action would not be barred by *res judicata* considerations, and that the trial court's concern for judicial economy is preempted by John's right to justice.

This issue was not raised by a motion to amend. The trial ended on August 21, 1986. On November 18, Gallagher and Erica John filed their proposed findings of fact. These proposed findings included their request that John pay $1,687,418 to De Rance on the theory of equitable disgorgement. When John retained new counsel, the trial court afforded him an opportunity to object to the new claim for relief. His objections were filed September 10, 1987, and a supporting brief was filed on October 10, 1987. Gallagher and Erica John filed replies to the objections and a supporting brief by November. A hearing was held November 17, 1987. The trial court filed its findings and conclusions on December 21, 1987, which, *inter alia*, determined that John had an affirmative obligation to make restitution for losses arising from his conduct, and ordered payment of $1,171,097.

[15]The section provides:

> **776.32 Jurisdiction.** Courts shall have jurisdiction over directors, managers, trustees and other officers of corporations:
>
> . . .
>
> To order and compel payment by them to the corporation whom they represent and to its creditors of all sums of money and of the value of all property which they may have acquired to themselves or transferred to others, or may have lost or wasted by any violation of their duties as such directors, managers, trustees or other officers.

[18]

John's arguments are meritless. As to the amendment of pleadings and notice, there was no amendment for which notice was required. The only post-trial change consisted of an additional form of relief. The body of the complaint remained unaltered. A prayer for relief is not a substantive part of the complaint. *Hertz Corp. v. Red Rooster Cheese Co.*, 55 Wis. 2d 701, 706, 200 N.W.2d 603, 606-07 (1972). The notice to which John was entitled is notice of facts. The complaint set forth facts that were not subject to the amendment motion. *See Wussow v. Commercial Mechanisms, Inc.*, 97 Wis. 2d 136, 146, 293 N.W.2d 897, 902 (1980) ("[I]t is the operative facts that determine the unit to be denominated as the cause of action, not the remedy or type of damage sought.").

In any event, John was given notice of the new relief demanded. He was given the opportunity to meet it and fully utilized that opportunity. His position was thoroughly aired and considered by the trial court. His constitutional rights were honored.

John's *res judicata* argument also fails. A new trial was not required because this action had not been completed. If John believed evidence that established gross misconduct was different from that necessary to prove a right to disgorgement, or if for any valid reason John believed additional defense evidence was required to contest the new relief demanded, he could have moved the trial court to open the trial for introduction of additional evidence. John protests, but he has failed to show the trial court or this court how proof of gross misconduct fails to support an award for equitable disgorgement.

[19]

We view this as a modification of the *ad damnum* clause to grant relief not demanded in the complaint but substantiated by uncontroverted proof. John made no showing whatsoever that the undisputed evidence will not support the additional relief granted. In *Lisowski v. Chenenoff*, 37 Wis. 2d 610, 629-30, 155 N.W.2d 619,629 (1968), the supreme court held that the trial court abused its discretion by denying a plaintiff's motion to conform the *ad damnum* clause to the undisputed proofs of damages where there was no showing of prejudice or surprise to the defendant. The burden of proof to establish prejudice rested upon the defendant. *Id.* at 637, 155 N.W.2d at

630. John has not met this burden; therefore, we conclude that the trial court did not abuse its discretion.

SUMMARY

In brief, we have determined that:

(1) the trial court was vested with subject-matter jurisdiction by sec. 776.32(4), Stats.;

(2) John was not denied his constitutional rights to exercise religious beliefs guaranteed by the state and federal constitutions;

(3) the trial court's finding that John was guilty of gross misconduct was not contrary to the great weight and clear preponderance of the evidence;

(4) we have refused to address the following issues because John failed to comply with court rules that require citation to authority: (a) corporate authority to institute the action; (b) lack of authority by John's attorneys to enter a stipulation for an injunction; and (c) denial of John's right to a trial by jury;

(5) the trial court did not abuse its discretion in granting the plaintiffs' pretrial motion to amend the complaint;

(6) De Rance owed no duty to John to indemnify him for costs of the action, and was not obligated to remain neutral; and,

(7) the trial court did not abuse its discretion in adding, after trial, a demand for relief based on uncontroverted evidence.

By the Court.—Judgment affirmed.

Recommend for Publication in the Official Report.

APPENDIX C

STATE OF WISCONSIN : CIRCUIT COURT
MILWAUKEE COUNTY

ERICA P. JOHN, as an Officer and Director of DeRANCE, INC., a Wisconsin Non-Stock, Non-Profit Corporation, et al.,	)	Case No. 650-555
Plaintiffs,	)	COURT'S DECISION
vs.	)	
HARRY G. JOHN, as an Officer, Director, and Trustee of DeRANCE, INC.,	)	
Defendant.	)	

August 21, 1986 Before the
HONORABLE MICHAEL J. BARRON
Circuit Judge, Branch 8,
Presiding

APPEARANCES: SMITH & O'NEIL, S.C., by
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Walter F. Kelly
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Milwaukee, WI 53211
For the Defendant

PROCEEDINGS

THE COURT: Before we commence with the decision, I want to formally congratulate the attorneys on the job that they did in presenting this case to the Court. There's no question that the plaintiffs' attorneys, Thomas and William Cannon, did a superb job in digging out crucial facts from thousands upon thousands of documents and presenting them in a cogent fashion to the Court.

Defense counsel, Bob Sutton, as well. Mr. Sutton came and saw me in January of 1986, indicated he wanted to represent the defendant, and whether I would object to it; and, frankly, I said no, I welcomed it because, frankly, I was getting concerned that defendant would not get a proper defense, and I was not disappointed. Bob Sutton is known as a fighter, and he aptly demonstrated it here during this trial.

I also want to make a minor apology for some rambling. I'm sure you're well aware of the fact that most judges, including me, write better than they speak, but I'm doing it this way for three big reasons: all concerned, whether it's parties, attorneys, or whoever, are interested in a quick decision in this case.

Second, the law is not that difficult. What you're talking about is a rather elusive concept of gross misconduct, and it really boils down to whether or not the defendant was guilty of gross misconduct in his relationships with the DeRance Foundation; and, since that's very difficult to define, it's really as Justice—or former Supreme Court Justice Potter Stewart once said when referring to pornography, "I know it when I see it." In other words, it's

in the eye of the beholder, and here that happens to be yours truly.

The third reason for giving a relatively quick decision, that the facts in this case are, for the most part, largely undisputed, and it's the inferences that you draw from those facts that would determine the outcome of this action.

As you all who are acquainted with this case probably suspect, I've agonized over what I consider one of the most fascinating cases that I've ever been involved with since I graduated from law school 27 years ago, and that became especially true as this hour drew nearer. Even at an outdoor mass at Irish Fest last Sunday morning the words of Bolduc, Kenney, Murray, Cuninggim, Sanders, Finley, Starr, Abraham, Nielsen, and others were dancing in my head. This agony is especially true in addition to that because in view of the very sad, humanistic personal tragedies which have occurred and are still occurring to the defendant, Mrs. John, and their nine children.

Further, it is agonizing because the matter involves a very dedicated, non-publicity-seeking man who is known worldwide for his charitable donations to the underprivileged.

At the commencement of this case and especially of the trial on April 14, I wondered if it would be better if a Jewish or Protestant judge might be more appropriate. However, as the evidence rolled in, I became more and more convinced that one who went to a Catholic grade and high school would better understand the terminology and the relationships within the Catholic Church. While any judge, regardless of religious affiliation or even atheistic, could determine this case, I am sure that my background gave me more of an insightful view as the parties could hope for.

First, let me tell you what I do not consider as issues in this case. One is Mr. John's dedication to the cause of alleviating human misery on this planet and of promoting traditional Catholicism.

The second thing I do not consider an issue is the support

for a Catholic television apostolate or presence—especially in the Los Angeles area. On these items there are no disagreements between the parties.

We have some things that have to be taken care of before we get to the main issue. The first is the counterclaim because to dispose of that is, in my judgment, very easy. The defendant alleges a conspiracy among the plaintiffs, Archbishop Pio Laghi, J. Peter Grace, J. P. Bolduc, Richard DeGraff, and Dr. Gallagher's wife, Idella, to take over DeRance Foundation. While it's true that the plaintiffs have been in control since a colleague suspended Mr. John on October 5, 1984, there's no evidence in my judgment whatsoever of any conspiracy involving plaintiffs. It's true Patrick Riley and Patrick Geary attempted to get Erica John to dump her husband and also Dr. Gallagher, but the conspirators failed to get Erica's consent. To the contrary, she spurned their efforts and continued working with the defendant and Donald Gallagher. J. Peter Grace's sole reference in this case was to permit Richard DeGraff and Bolduc to work for DeRance while W. R Grace Company was paying their salaries. DeGraff himself only worked until the end of May of 1986 in a middle-management capacity and was really not involved. In fact, he didn't even testify in this case.

And as to Bolduc, that is, the request by Mr. Grace to have Mr. Bolduc, who was the chief financial officer of W. R. Grace Company, the only testimony we had there was that he was required to work with DeRance only when he could spare time from his employer, W. R. Grace Company.

Another alleged conspiracy was Dr. Gallagher's wife, Idella Gallagher, and she was hardly referred to in the trial at all except to mention her salary.

Mr. Bolduc, who was the first witness in the case, was in my judgment a human dynamo type whose management style was somewhat terse, but was obviously necessary to turn around the financial and managementless chaos that he found in all the areas of DeRance and Santa Fe Communications. There's no evidence that he wants to be

involved with the plaintiffs at all. A clean sweep was imperative from his point of view, and he accomplished it and was then gone.

For those of you who are unaware of what Santa Fe Communications is all about, this was a public charity that was formed by the parties, that is, Harry John, Erica John, and Donald Gallagher, back in around 1982 primarily to avoid the problems that are created under the Tax Reform Act of 1969, which prohibits a private foundation from getting involved in any private profit-making business to the tune of more than 20 percent. Therefore, this public charity was set up and founded by these people. However, on the other hand, it is totally funded by DeRance either in the form of loans or grants.

Archbishop Pio Laghi, another alleged conspirator, is the ambassador from the Vatican to the United States, and he summoned Erica John and Donald Gallagher to Washington , D.C., approximately ten days prior to the action being commenced because he was, quote, concerned about what was going on in Milwaukee, and something had to be done. From the evidence that I heard, he was correct. When the world's largest Catholic foundation, which had started charities and missions worldwide, was on the brink of collapse, any cleric should be concerned that the funding spigot was about to be shut off. That's hardly a consipracy against the defendant.

Next we have to painstakingly go through the affirmative defenses, most of which were not even argued in final arguments by the defendant. The first one was that the Court lacks equity jurisdiction. Well, there's no question about the Court's jurisdiction in equity on the inherent power basis and also pursuant to Section 776.32 of the Wisconsin Statutes.

The second one relates also to equity jurisdiction, and that's an allegation that there was too much entanglement, if you will, between a religious organization, that is, DeRance Foundation, and the public. That's also denied. It's true that

most of the grants made by DeRance Foundation involved Catholic-related organizations. There is nothing to prohibit other charities from benefiting. If I recall at some of the earlier evidentiary hearings that we had in this case, there were things such as Concordia College, which is Lutheran-orientated, and Bell Canto Chorus that also benefited from DeRance Foundation.

More important, it is set up under Wisconsin civil law, that is, DeRance Foundation, and our statutes will govern defendant's conduct as well as he is governed and as the foundation is governed under federal statutes and regulations.

The next allegation is that the real party in interest in this case was Archbishop Pio Laghi, that is, the Vatican delegate. This was denied a long time ago in a motion to dismiss. The same ruling and reasoning would apply here.

The next allegation is that the Wisconsin Statutes require prior board approval of the plaintiffs bringing this action. I see nothing in the Wisconsin Statutes to require that the board approve Dr. Gallagher and Erica John from bringing the lawsuit.

The next one was that there was no special meeting notice to the defendant on this commencement. Again, the statutes don't require any notice to the defendant of a special meeting in order to start the lawsuit.

The next one was that there is no permission to grant a temporary restraining order suspending Mr. John. I think that's obvious that the statutes do permit a temporary restraining order to be issued ex-parte, and there's no constitutional violation which was mentioned in the affirmative defenses ever argued by the defendant.

There was also an objection to the stipulation for a temporary injunction. That was handled I think last September, almost a year ago, and the same ruling that I made at that time would apply at this time.

There was next a complaint in paragraph 8 of the

affirmative defenses about insufficient funds in order to properly prepare. We went over that, not only in early 1985 when defendant was represented by other counsel, but more important back in I believe March of 1986, and at that time, upon the defendant's request, I granted it partially contrary, in my judgment, to statute. I bought Mr. Sutton's partner's argument about being fair in this and being equitable, and I required DeRance to loan some money, in this case $25,000, to the defendant so that he could properly prepare and present a case.

Next one was about civil process being denied. I don't know what that means. Nothing was ever argued. There certainly wasn't any civil process to my knowledge denied the defendant.

The next argument relates to an attempt allegedly on the part of the plaintiffs to convict Mr. John of violations of securities law. There is no such attempt that I know of. What was done here is that the plaintiffs were claiming gross misconduct on the part of the defendant, partially based on violation of Securities and Exchange Commission rules. Therefore, it's not necessary to have jurisdiction in the federal district court.

The next one, which is paragraph 11, relates to statute of limitations and alleged securities law violation. The same ruling would hold true here because there was no argument ever made by the defendant relating to statute of limitations violation.

The 12th paragraph related to me alleged tax violations, which are to be jurisdiction in the federal district court, and again the same comments I make here or I should say the ones that I made on the SEC alleged violations would be applicable here; that is, the plaintiffs are not prosecuting the defendant on alleged tax violations. What they are doing is alleging gross misconduct and using alleged tax violations as evidence of gross misconduct.

The 13th for the defense relates to participation on the part of the plaintiffs in the alleged wasteful or illegal

violations. I will comment on those when I get to the area relating to the allegations in the complaint.

The same is true relating to defendant's capacity as a trustee since the underlying power and the real power in DeRance Foundations exists in the trustees. All the trustees do, and for the uninitiated, the trustees are the ones who meet yearly to appoint the board of directors. There are only two trustees—Donald Gallagher and Harry John. Those two, along with Mrs. John, make up the board of directors. Obviously, if you are a trustee, you have the power to appoint the board, and while the board is the one who sets the general policy of the foundation, the trustees have the real power, and that's to make sure who gets elected to the board.

The 15th affirmative defense relates to the internal remedies being available to the board. That's true, that there was some internal remedies that were available, but I don't think that that's legally impermissible on the part of Erica John and Donald Gallagher to bring the lawsuit. In addition, those internal remedies did not exist for the trustees since there's only two of them. And neither one, unless there was a concensus, that is, both Dr. Gallagher and Mrs. John, or Mr. John, could exercise any power without the consent of the other. Because of this power that exists inherently with the trustees, it's important to deal with the defendant in all of his capacities whether it relates to his capacity as director, trustee, chief financial officer, treasure, president, CEO, or whatever other title that he had with DeRance.

The next one in paragraph 16 relates to that the plaintiffs came in on allegedly unclean hands, and I will comment again on that when I discuss the complaint.

The 17th one as well will be discussed when I comment on the plaintiff, and that's the alleged gain in the assets' value during the tenure of Mr. John.

The last one, which is paragraph 18, was the Court permitting the amended complaint. There's good reasons why the amended complaint was permitted because it wasn't until all the documents that were requested by the plaintiffs

were furnished to the plaintiffs until 1986, in some cases within two weeks prior to the trial. Further, the Court wanted to get a complete picture of DeRance Foundation from day one through the time of the trial. That takes care of the affirmative defenses, which are all denied.

As I indicated before, defendant was totally non-publicity seeking for himself and the foundation that he created in 1946, only five years out of college. Thus, most Catholics, let alone other Milwaukeeans, were unaware of its existence. I first learned of it and then not very much while serving a five-plus-year stint on the Milwaukee Archdiocesan Board of Education from 1977 to 1982 and especially the last year when I was president. As Mr. Sutton said, it's a rare individual who not only forms a foundation for charitable purposes, but funds it with most of his inheritance from the Miller Brewing Company. This was accomplished by 1954 or 1955. The defendant testified this was about 47 percent of the stock in that privately held company, with his sister, Lorraine John Mullberger, owning the balance or, that is, the majority share in the brewery.

Since it was a private company, and the company was more interested in growth of dividends, Mr. John testified that the dividends that were spun off—he didn't give any year, but I assume he meant in the 1960s—it amounted to about $400,000 a year in dividends that was available for DeRance. While this obviously would provide a comfortable living for any family, it was not much to deal with, and when you consider the goals of the defendant in the foundation, and defendant and his family lived a rather spartan life for a number of years with no salary accruing to the Johns for their foundation work.

But then came the 1970s, and things changed dramatically. Contrary to Attorney Thomas Cannon saying the problems began with the first warning letter on January 12, 1984, the Court believes the genesis occurred in the early 1970s when Phillip Morris bought DeRance's minority share in the Miller Brewing Company for $97 million. Combining that with the five to eight million dollars that was received

in a settlement that the foundation got from a lawsuit against the W. R. Grace Company, now suddenly this relatively tiny foundation had a huge sum to invest and dispense. Frankly, the Court believes this task was overwhelming for all parties to this lawsuit. It is how they coped and reacted where the genesis of disagreement was born.

The next aspect concerns the burden of proof. While the plaintiffs filed a trial brief last April of 68 pages including 35 pages on the law, the type of burden of proof was never mentioned. Defendant also filed no brief at all, but mentioned in his closing argument that it should be beyond a reasonable doubt or at a minimum so-called middle burden or higher civil burden; that is, by a clear, convincing, and satisfactory evidence as opposed to a preponderance of the evidence. The Court will apply the so-called fraud middle standard in its ruling. There is no authority that I know of that will apply a criminal burden of proof for a civil case. Even though there was no authority set by either side, I believe that the middle burden of proof should be preferred since it seems to be a more appropriate standard for a case of this type.

The Court indicated at the conclusion of the plaintiffs' case in chief at the end of May that it would state why the defendant's motion to dismiss ought to be denied. Frankly, I feel like the little boy who confronted the old baseball hero, Shoeless Joe Jackson, over 65 years ago following the revelation of the so-called Chicago Black Sox scandal when he said to Shoeless Joe, "Say it ain't so, Joe." The reason for my feelings is that the incidents of misconduct on defendant's part were so overwhelming that I was hoping during defendant's case for some explanation of that conduct which would permit me to deny plaintiffs' relief. I was saying to myself, "Say it ain't so, Harry." This was due to my reverence for a man so dedicated to the world's unfortunate that over a hundred and twenty-five million dollars was given by DeRance over the years and the selfless life he had led for so many years.

Unfortunately, in my judgment, money reared its ugly head, and something happened to Harry John in the 1970s,

and it progressed worse in the 1980s. It was not just his desire for a Catholic TV apostolate. Rather, it was his total obsession for money—not for personal creature comforts, although there was some of that too, but rather control over money, a desire to earn more and more and more. This is reflected in his retention and dismissal of money managers, the staying with Noble Trenham and Fred Astman, who were successful in the short run in their highly illiquid portfolio, the investment personally and for DeRance in Mexican mutual funds, gold futures, a silver mine in Coeur d'Alene, Idaho, and deep sea treasure hunts and the constant monitoring of his own and DeRance's assets with First Wilshire. He seemed to me to be a man possessed.

Harry John also has a domineering personality. This came through with all witnesses with whom he had contact. There is no question that he was, in fact, the foundation—legally and, more important, factually. Plaintiffs were primarily subservient to Harry John's wishes. While this nonfeasance was wrong legally, it is understandable for a wife and old friend not wishing to contravene the desires of a man who donated much of his fortune in life to serving his Creator. This domineering attitude, unfortunately, became his downfall. It was his obsessive, all-consuming desire to fund, construct, and operate a solely Catholic TV network at all costs that brought this matter before the Court. For Harry John it was, "Damn the torpedoes, full speed ahead." Thus, it is not surprising that he ignored almost totally the advice of experts he retained to control spending and formulate and operate within a budget.

It further explains his refusal to adhere to the objectives of the plaintiffs. For all those years they went along with him. Why not now?—just when his goal was in sight. How dare those experts and the plaintiffs challenge him? It's easier to call them infidels or workers of the Devil or only acting in their own self-interest than to accede to their reasoned advice. It also explains why he turned to those who used Harry John's naivete for their own benefit, but who went along with his and their wild schemes to make more

money quickly. I speak of Norman Kirst, Jack Grimm, Jack Good, Stanley Ditchfield, Alphonso D'Artega, and others of thier ilk. Mr. John had to have a number of yes man hanging around and telling him what a great man he was, all the time sponging off his generosity and naivete. The defendant is no dummy when it comes to investing. Yet his testimony was filled with "I don't know's" and "I don't recall's." He lacks any credibility whatsoever and would only admit his errors when confronted with unrefutable evidence.

It was a combining of events that led to the eventual court suspension. The defendant keeps mentioning the value of Fund E, that is, the stock and bond account, on June 30, 1983, at some one hundred eighty plus million dollars. In one way he was a victim of circumstances. The long-awaited stock market rally began in August, 1932, and shortly after that June 30, 1983, date it receded again for about a year and a half with a new boom commencing in January of 1985. Thus, it was in the very period when stocks were going down that DeRance's and its offspring, Santa Fe Communications', cash requirements were mounting every increasingly. While Fred Astman may be correct that if you own enough small companies, they sould outperform the market, that is not true in a declining market and especially so when you own such large positions in highly illiquid securities which make them unmarketable without suffering a huge discount or haircut as mentioned in the September, 1984, letters of Fred Astman and Attorney John Miller.

Thus, defendant should have immediately formed a budget in 1983 and discussed a restructuring of the portfolio to meet the needs of Santa Fe Communications. Defendant did neither of these and ignored all warnings to curtail spending that went as high as $2 million a week.

That intentional waste and mismanagement in itself may not amount to gross misconduct, but when combined with the self-dealing front running, investing in other wild schemes totally inappropriate for a foundation, and market manipulation clearly reflects the grossness of Harry John's misconduct.

Then you add to it his failure to disclose his personal investments to the board, his failure to disclose his foreign Liechtenstein account and Cayman Island accounts to the IRS, and his perjury, his phoney travel expense voucher to HBIAC—that's a company that legally owns the television station which was partially then and now totally owned directly or indirectly by DeRance—and securities fraud make it impossible for this Court to say that this misconduct was anything but gross.

I'm not going to detail all the items of tax fraud, perjury, self-dealing, front running, securities fraud, et cetera. They were definitely proved beyond any doubt, let alone reasonable doubt or by clear and satisfactory evidence. It was all testified to in the trial and summarized in final argument to be included in the findings of fact and conclusions of law.

Defendant says that the plaintiffs voluntarily paid a jeopardizing tax for the ill-conceived sea salvage ventures. The evidence discloses it was due on a self-assessment basis and could have easily resulted in a higher penalty if not so declared.

What about the other defenses raised by Mr John? Unfortunately, Harry never said, "It ain't so." With the exception of Saul Pick and Waldemar Neilsen, I was not impressed with most of defendant's witnesses. Jack Good had some good credentials, but I feel in this instance he took advantage of Mr. John. Many of the witnesses such as Mrs. Vernon and Father Clements from Chicago were of the character type and, as related, there's no issue concerning Mr. John's benevolence in the past. I'd be surprised if any of them were not grateful to Harry John. The anthropologists were basically worthless. One did mention the value of deep sea salvage. The problem is that this was not a grant for scientific purposes, but rather an alleged investment to make a fortune. They are totally different. Even if it didn't turn out to be a hoax by the O'Connells, it was a totally imprudent expenditure. Further, that so-called expert had never dived over twenty feet, let alone six to nine thousand feet down where the Central America boat supposedly is resting.

Mr. Pick seemed a sincere man trying to provide a different angle to the scenario. I don't doubt his sincerety about the quality of production, but I believe he was mistaken about the possible buyer of the Centro equipment package since the documentary evidence is to the contrary.

Mr. Neilsen was by far the most important defense witness, and I mulled over his words long and hard. Nonetheless, I feel he is wrong when he said plaintiffs' options were to resign and leave it to the governmental authorities to prosecute. Mr. Neilsen had never been prepped on most of Mr. John's illegal deeds. Even the plaintiffs were unaware of most of them until 1986 when the secretive documents surfaced. If not for plaintiffs starting this lawsuit, those deeds probably would have gone undetected with the exception of the sea salvage jeopardizing tax being paid.

Mr. Neilsen also said there was nothing wrong with a foundation spending itself to nothing. I don't disagree with that at all. But that's not what the goal was in the articles and by-laws, and more important not the goal or aim of any of the plaintiffs nor Mr. John. They were not intending to spend this foundation down to nothing. Mr. Neilson also said it was the first time in the history of the United States that any attempt had been made to oust a founder-donor of a foundation. If that's true, and I don't know if it is or not, this Court does not shy away from its responsibilities.

What about the plaintiffs, Mrs. John and Dr. Gallagher, authorizing many of these wasteful expenditures? There's no question in the Court's mind that the plaintiffs were guilty of some nonfeasance in their voting to commence sea salvage and on some of the decisions relating to the the TV network. However, collectively those decisions would never be sufficient to suspend, let alone oust, the plaintiffs from their positions.

I'd call it bad judgment on plaintiffs' part, but not gross mismanagement. More important, it's crystal clear Harry John was the dominant authority urging on those projects plus on many occasions presenting invoices for expenditures

he had already authorized personally without the okay of the board. On those, it was either ratify or be sued.

Plaintiffs should have insisted on a budget before commencing this project—especially one of the magnitude of the Catholic TV apostolate—and, if the defendant didn't present one, as he should have, that was his responsibility. They should have stopped the project before it had gone as far as it did. However, without Mr. John, there wouldn't have been a project at all, and it was his insistence on the spending that prevailed.

Plaintiffs also should have monitored the investment portfolios to a greater extent than they did. If they had, perhaps Harry John could have been stopped earlier. However, no way can you compare plaintiffs' nonfeasance with Harry John's malfeasance, plus plaintiffs were unaware of most of the illegal deeds of the defendant.

Defendant complains of the lawsuit being started rather than having the plaintiffs vote to the contrary. Frankly, in my judgment, after hearing all the evidence, I believe it should have been commenced four months earlier when defendant was almost totally ignoring the plaintiffs' and other consultants' wishes on the level of expenditures. If the plaintiffs are guilty of any nonfeasance on this matter, it is not in moving earlier to stabilize the foundation.

I don't fault Mr. John for a number of his decisions relating to the Catholic TV apostolate—not only in starting it, but also in the decision not to go with Pepperdine or Marymount nor with the decision to ultimately rent a transponder. Those are decisions with which reasonable persons could differ. I don't also fault his desire for an all-religious programming or even to buy quality equipment. Again, these are relatively reasonable decisions, and the Court should not step in and determine if Mr. John is incorrect in that.

However, the waste in construction, the timing of the transponder lease, the vast number of employees, the setting up of a number of expensive production units for which

Santa Fe got very little, the ignoring of the board's decision to cap spending, and the ill-advised taking over production by an inexperienced defendant were obvious mismanagement on defendant's part. These are not differences of opinion, nor are they items that the Court should be overlooking.

Defendant also says the investment portfolio was so manned by the defendant that no other foundation ever had such a price appreciation. First of all, there's no evidence to support that conclusion. Second, you can't use, in my judgment, the alleged worth of the Miller Brewing Company stock which was testified to by Mr. John of $14 million in the early 1950s as a base. This was a private corporation basically with two stockholders, and no one really knows what that minority interest of DeRance was worth in the Miller Brewing Company in the mid 50s and even during the 60s. The real starting base comes in the early 70s after the sale to Phillip Morris when DeRance was worth over a hundred million dollars. Increasing that to a hundred and eighty-three or a hundred and eighty-eight million dollars by June 30, 1983, is fine, but not fantastic. Plus having illiquid, thinly traded stocks may be satisfactory in a rising market, but totally imprudent when it declines and especially so when huge cash withdrawals are contemplated or occurring. Stock values are fine until it's time to sell, and then you say, "To whom?" There is nothing wrong in having some of these stocks in a diversified portfolio, but nowhere near the magnitude held by DeRance. Further, it was the huge positions taken in some of these small companies that likewise created a liquidity problem. You don't have to be an expert in the stock market to know that. It's basic high school or college economics on the law of supply and demand.

Frankly, I was shocked when I heard the type of investments DeRance was involved in without ever knowing of Mr. John's personal parallel investments. It doesn't take a Wall Street consultant to know that silver mines, Mexican mutual funds, gold futures, and illegal securities, let alone deep sea treasure hunts, are totally imprudent for a foundation's portfolio. Then when I heard of the secret

Liechtenstein gold account, the secret funneling of foundation funds to defendant's personal Sea Search Armada, the selling of his own stocks to the foundation, the front running by defendant with his stocks vis-a-vis the foundation, and the market manipulation, I thought I had heard everything.

I was wrong. The hoax perpetrated by the O'Connells would be laughable if it weren't so tragic since every dime lost means that much less for the earth's needy. It's incredible to learn defendant sunk—and that's not a Freudian slip—some of his own money with those charlatans from South Hampton, England, in 1985 after he was suspended. Defendant's breaches of duty and loyalty for the foundation were only exceeded by his gullibility.

Thus, the sad saga of Harry John's involvement with his life's dream with DeRance has terminated. To say that I am very concerned about him in the future is an understatement. This Court does not profess to be an expert in diagnosing illnesses. However, it's obvious that Mr. John has some deep-rooted inner problems that need to be rectified, and soon. Instead of consulting a star-gazing parapsychologist, he ought to be seeing a qualified psychiatrist. Hopefully, he can regain the affection of his family and the respect he has enjoyed in the Philanthropic world.

The foundation now seems to have stabilized through the management techniques installed by Mr. Bolduc. While certainly not heavyweights in the management field, especially in managing so large a sum, the plaintiffs at least have the good sense to retain experts, listen to their advice, and act upon it.

Now that this drama has concluded, perhaps all can get on with their lives and, as Erica John testified, "To carry out Harry's desires." Unfortunately, it must be without him since pursuant to the equitable powers of this Court and Section 776.32(4) of the Wisconsin Statutes, the defendant is permanently enjoined from participating in his positions

as trustee and director of DeRance Foundation.

Counsel for plaintiffs will draft proposed findings and conclusions, that is, findings of fact and conclusions of law, and the judgment pursuant to our local court rules.

* * * *

STATE OF WISCONSIN)
) SS:
MILWAUKEE COUNTY)

I, Linda J. Levengood, an official court reporter in and for the Circuit Court of Milwaukee County, do hereby certify that the foregoing is a true and correct transcript of all the proceedings had in the above-entitled matter as the same are contained in my original machine shorthand notes on the said trial or proceeding.

Dated at Milwaukee, Wisconsin this 22nd day of August, 19 86.

/s/ Linda J. Levengood, RPR
Official Reporter

APPENDIX D

STATE OF WISCONSIN : CIRCUIT COURT
MILWAUKEE COUNTY

ERICA P. JOHN, as an Officer and Director of DE RANCE, INC., a Wisconsin Non-Stock, Non-Profit Corporation, and DONALD A. GALLAGHER, as an officer, Director, and Trustee of DE RANCE, INC.,	)	SUPPLEMENTAL DECISION
Plaintiffs,	)	Case #: 650-555
vs.	)	
HARRY G. JOHN, as a Director and Trustee of DE RANCE, INC.,	)	
Defendant.	)	

In their 117 pages of Proposed Findings of Fact, Conclusions of Law, and Order filed November 18, 1986, plaintiffs requested, inter alia, the Court to order defendant to pay De Rance, Inc. the sum of $1,687,418.00 in equitable disgorgement damages. Defendant objects to this request on a number of grounds.

Following the above submission, defendant decided to retain new counsel. It took until February, 1987 before a suitable arrangement could be effected, a delay to which neither the Court nor opposing counsel had any objections.

Thereafter, it was agreed by all concerned that new counsel would have ninety (90) days following the completion of all transcripts to file objections to plaintiff's submission. Eventually defendant did so file 95 pages of objections on September 17, 1987 with a supporting brief arriving around October 10, 1987.

Plaintiffs, in turn filed 144 pages of replies to those objections on November 6, 1987, along with a supporting brief. Oral argument on same was heard November 17, 1987. Because of the issues raised by the parties on the disgorgement request, the Court determined to render this Decision with the amount of any damages contained in the Court's Findings, Conclusions, and Order.

Five (5) grounds are raised in defendant's brief as reasons for denial of plaintiffs' request. They will be treated in the order raised therein.

First, defendant claims that the Court has no jurisdiction because De Rance, Inc. is not a party. While technically that is true, there can be no doubt that the two (2) plaintiffs are acting in their representative capacities as directors and officers of the foundation, and in Dr. Gallagher's case also as a trustee.

Further, the foundation ratified the commencement of the suit at bar and Sec. 776.325, Stats. provides the remedy to oust someone in defendant's positions inures only to a creditor, stockholder, director, trustee, or officer of the corporation. Since corporations possess no such remedial right, the action had to be brought as it was. The foundation is bound by any beneficial or adverse Decision of this Court. Thus the first ground is denied.

The second and third grounds are interrelated; i.e., Sec. 776.32(4), Stats., upon which the action was grounded, provides no disgorgement remedy and defendant was not given notice of plaintiffs' request until the submission on November 18 1986, or almost three (3) months after the evidence and arguments were concluded.

It is true that the quoted subsection provides no such relief. However, another subsection, Sec. 776.32(2), does so permit recovery and the real question involves the notice issue. [The latter subsection also makes clear plaintiffs' right to act in a representative capacity for payment from the defendant to a non-party corporation].

Defendant claims he had no opportunity to defend against the disgorgement claims since he had no knowledge it would be sought. While the Court agrees it would have been better that either Sec. 776.32(2) or the word "disgorgement" had appeared in the original or amended complaint, it is satisfied that plaintiffs have complied with Wisconsin Law and due process to justify any claim proved.

State vs. Peterson, 104 Wis. 2d 616, 312 N.W. 2d 784(1981) restates a number of the rules concerning amending of a complaint to conform to proof in interpreting Sec. 802.09(2), Stats. In addition, *Peterson* provides a methodology to be employed by a trial Court in determining whether to so amend.

The second sentence in Sec. 802.09(2) is only applicable when defendant objects that the profered evidence is not within the pleaded issues. The judge would then determine if it was in the interest of justice to so amend and, if so satisfied, permit the evidence. Herein, the Court recalls no such objection by defendant's trial counsel. He did object throughout the trial on relevancy grounds, but not on the grounds of not being pled.

The first sentence requires either express or implied consent. Herein there was no express consent, and the mere fact that plaintiffs profered evidence on the ouster issue does not automatically mean defendant impliedly consented to try an issue allegedly not pleaded. *Peterson,* Id. P. 631.

"To find implied consent it must appear that parties understand the evidence was aimed at the unpleaded issue." Id. P. 630. P. 631. ". . . (a)nother test might be used in place of actual notice . . ., namely whether the defendant was prejudiced by the amendment." Id. P. 632.

The above quotes are taken from *Peterson* in our Supreme Court's analysis of the Federal counterpart [Rule 15(b)] of Sec. 802.09(2), Stats. However, our Court believes a trial Court can so amend if it finds either (1) actual notice or (2) that justice so requires. Id. P. 634. Herein the Court finds both have been satisfied.

As to the former, it must be remembered this is an equitable action wherein a Court should ". . . (e)xercise its jurisdictions in an effort to do complete justice between the parties to the action." *State vs. Excel Management Serv., Inc.* 111 Wis. 2D 479, 491, 332 N.W. 2D 312 (1983). Thus the Court should fashion remedies to conform to the proof adduced, and not be bound by the formalities of the relief requested in the complaint, especially where only "notice" pleadings are sufficient.

Further, the amended complaint alleges that defendant invested in securities paralleling the foundation, some of which were sold by him to De Rance, and that he earned huge profits by "scalping" De Rance's investments on those same securities. This alone is sufficient to put defendant on notice that repayment would be requested.

Further, plaintiffs' trial brief mentioned defendant's "front running" and "self-dealing" on the parallel securities and itemized the profits to which defendant enured. It also cited *Old Settler Club vs. Haun*, 245 Wis. 213, 13 N.W. 20 913 (1944) wherein the Court held repayment of profits by a director to a corporation is required when self-dealing is found.

One witness, Raymond Sims, detailed the amount of profits accruing to defendant as a result of self-dealing and front-running in parallel securities. Other witnesses, such as Carmine Asselta, Roger Murray, and Michael Sanders related the inappropriateness of this activity on defendant's part. The latter also asserted the requirement on plaintiffs' part to seek reimbursement for the foundation.

There was better than a three (3) week interval in the trial in June, 1986 between plaintiffs resting their case-in-chief and the commencement of defendant's evidence. That was more than sufficient time for defendant to introduce any rebutting evidence. None, however, was profered.

Further, other evidence, including exhibits, detailed the false expense account statement and the funneling of foundation funds to defendant's personal deep sea treasure

hunt venture.

Finally, Atty. William Cannon, during his final argument, clearly indicated plaintiffs' intentions to seek disgorgement relief. No objection to that pronouncement was voiced, nor was there any request for continuance to introduce evidence thereon.

With all of the above, the Court was well aware of plaintiffs' determinations, and the only question in the Court's mind was how much would be sought. It is hard to believe defendant could be unaware that disgorgement was being sought. The Court finds actual notice was given and thus defendant consented to try that issue.

In addition, the Court believes it would be inequitable not to include in the final Order a Decision, including all disagreements by the parties. Res Judicata Principles should bar further litigation between the parties. Even if not available to defendant, it would be a waste of judicial time to reintroduce the same evidence in any subsequent trial wherein relief more than ouster was requested.

Plaintiffs' evidence was mostly uncontroverted, and the ultimate determination by the Court involved not a fact finding on conflicting testimony but, rather, whether the conduct of defendant amounted to gross misconduct sufficient to oust him. As indicated orally, that evidence was overwhelming. Thus the interests of justice dictate that all issues be determined, including disgorgement.

Fourth defendant claims it would be impossible to separate legal and illegal profits and cites *Commodity Futures Trading Commission vs. Hunt*, 591 F2D 1211 (7th Cir. 1979) to support his position. Reliance thereon is misplaced.

Hunt concerned an effort by the commission to enjoin the Hunt family from violating the Commodity Exchange Act, and its administrative regulations, and to require the family to disgorge its profits.

The law prohibited, inter alia, anyone from exceeding

three million bushels in soybeans futures contracts. While finding violations thereon by the Hunts, the district court refused to enjoin or permit disgorgement.

Upon appeal, the 7th Circuit affirmed the violations, but determined the trial Court was in error on the injunctive relief and disgorgement rulings. It was in that context that remand was ordered for the trial judge to separate legal and illegal profits.

Thus any profits on contracts up to three million bushels was permitted, but over that disgorgement should be ordered after a hearing. Herein all profits garnered through self-dealing or front-running are disgorgeable.

Once wrongdoing on defendant's part is established, the burden shifts to defendant to show that any profits were garnered through his own labors or initiatives. D. Dobbs, *Handbook on the Law of Remedies*, P. 244. Again no such evidence was introduced, and the presumption is that they were thus all caused by his wrongdoing. Plaintiffs in equity may show what defendant gained rather that lost.

Finally, defendant claims the disgorgement relief is punitive in nature and thus not allowable in an equitable, citing *Karns vs. Allen*, 135 Wis. 48, 115 N.W. 357 (1908).

Two (2) principles will adequately dispose of that argument. First, disgorgement is not punitive in nature. In fact, *Hunt*, supra, in citing 2nd Circuit cases concerning this remedy involving violations of the Securities Exchange Act related the 2nd Circuit was ". . . (c)orrectly reasoning that disgorgement does not penalize, but merely deprives wrongdoers of ill-gotten gains." *Hunt*, supra, P. 1222.

Second, even if considered punitive in nature, the modern view is that Courts of equity may order exemplary relief. *White vs. Ruditys*, 117 Wis. 2D 130, 343 N.W. 2D 421 (Ct. App. 1983).

While the intermediate Appellate Court has no authority to overrule the Supreme Court, it strongly believed the eighty (80) year old view in *Karns* would be reversed if the issue

was currently before our highest Court. It did so based on a number of more recent out-of-state Decisions plus dicta from *Wussow vs. Commercial Mechanisms, Inc.* 97 Wis. 2D 136, 293 N.W. 2D 897 (1980), and other legal authorities.

In summary, all of defendant's grounds for denying disgorgement relief are rejected, and same will be included in the Court's Order

Dated at Milwaukee, Wisconsin, this 23 day of December, 1987.

BY THE COURT:

/s/ Michael J. Barron
Circuit Judge

APPENDIX E

Securities Fraud: Market Manipulation

45. Defendant manipulated the market price of those securities, in which both defendant and De Rance held parallel positions, to the financial advantage of defendant. [Sanders Tr., p. 36] The Court adopts by reference those findings set forth in paragraphs 20 through 37 above. The Court finds that this conduct was contrary to the provisions of Sections 9(a)(2) and 10(b) of the Securities and Exchange Act in that it constitutes the species of securities fraud known as "market manipulation".

Securities Fraud: Front Running

46. In 19 of 44 parallel securities, defendant purchased his stock first, followed by De Rance's large purchases, followed by defendant's sale of his positions. [Ex. 346] In most cases defendant's initial purchases were made a few

days prior to the commencement of the foundation's buying program in the same security. [Ex. 346] This sequence of transactions allowed defendant to take full economic advantage of De Rance's substantial purchasing power in this market of thinly-traded, highly illiquid, limited marketability securities in that First Wilshire's large purchases for De Rance's account (with the knowing cooperation and encouragement of defendant) inevitably caused a rise in the price of defendant's previously purchased stock in those same securities. The net effect of defendant's "front running" his purchases to De Rance's was that defendant's investments in the 44 parallel securities returned a 30% greater profit to defendant than De Rance's investment profits in these same 44 securities during the same period of time that both held simultaneous positions. Defendant earned a 39% profit while De Rance earned a 30% profit in these same securities during the time they were simultaneously held.

Securities Fraud: Misappropriation of Confidential Information

47. Defendant, using insider knowledge of material, nonpublic information about De Rance's impending securities transactions, purchased securities for his personal account with knowledge of the fact that De Rance would follow him into these same securities with large purchases in this market of thinly-traded highly illiquid securities. [Asselta Tr., ii, p. 19; Murray Tr., p. 34] Defendant's positions with De Rance created a fiduciary relationship of trust between defendant and De Rance. Defendant breached his fiduciary duty by misappropriating material, nonpublic information about imminent large purchases that he knew would affect the market prices in these types of securities. Defendant then acted upon the misappropriated information to his personal financial advantage. [Ex. 437] This conduct on the part of defendant constituted a securities fraud in violation of Section 10(b) of the Securities Exchange Act, 15 U.S.C. §78j(b).

Securities Fraud: Filing False 13-D Schedules with the Securities and Exchange Commission

48. Defendant personally and in his capacity as president signed and caused to be filed on behalf of De Rance numerous 13-D schedules with the Securities and Exchange Commission. Defendant stated on these schedules: "De Rance, Inc. and Harry G. John do not constitute a partnership, limited partnership, syndicate or other group for the purpose of acquiring, holding or disposing of the shares of common stock of [named security]. Mr. John expressly disclaims any economic beneficial interest in the holdings of De Rance, Inc." This schedule was submitted in connection with a number of different securities [Ex. 431, 432, 433, 434].

49. These 13-D statements were materially false in that defendant knew that he was in fact acting for the purpose of acquiring, holding, and disposing of securities in such a way as to confer upon defendant an economic beneficial interest in the holdings of De Rance as more particularly set forth in paragraphs 20 to 37 and 46 to 49 of these findings. [Astman, Murray, Sims, and Asselta Tr.]

50. Defendant willfully made such false statements with the intent to deceive plaintiffs and the Securities and Exchange Commission by concealing his personal financial interest in the holdings of De Rance.

Securities Fraud: Failure to Disclose Identity of Cross-Trades to De Rance

51. Defendant owed a duty to De Rance to disclose that he was the seller in the 23 cross-transactions set forth in paragraphs 34 through 37 because, as chief financial officer, director and trustee of De Rance, he was also on the buyer's side of these transactions. Defendant's sale of his stock to De Rance created a conflict of interest because defendant's personal financial security was tied to his ability to find an unwitting and convenient buyer for his stock (i.e. De Rance). Furthermore, it was in De Rance's best interest to pay the

lowest price possible for such securities while it was in defendant's best interest to receive the highest possible price for such securities. Failure to disclose such a conflict of interest to the buyer constitutes another species of securities fraud contrary to Section 10(b) of the Securities Exchange Act.

Tax Fraud: 1983 and 1984 Income Tax Returns

52. Defendant's personal income tax returns for 1983 and 1984 personally signed by defendant under penalty of perjury, denied having "an interest in, or a signature or other authority, over a bank account, securities account, or other financial account in a foreign country." [Ex. 340 and 412]

53. Defendant knowingly gave false answers to these questions (Schedule B, lines 11 and 16) in that defendant did maintain a securities account in Mexico during 1983 and 1984 in certain Mexican mutual funds. [Ex. 414]

54. Defendant also knowingly gave false answers to these same questions in that the defendant did maintain a bank account at the Bank of Vaduz, in Liechtenstein. Defendant attempted to conceal his ownership of this account by opening it under an assumed name, i.e. "Quorum Anstalt", in 1983 and maintained it in 1984. [Ex. 395-407; Sarnoff Dep. Tr., 4/8/86, pp. 8-71]

55. Defendant also knowingly gave a false answer to this same question in that defendant did have authority over accounts at the Bank of America and Barclay's Bank in the Cayman Islands during 1984. [H. G. John Tr.]

56. Defendant's false answers on his 1983 and 1984 federal income tax returns enabled defendant to avoid filing additional forms with the Internal Revenue Service which would have required defendant to make detailed financial disclosures concerning his foreign accounts. [Schweitzer testimony] These false answers were part of defendant's scheme to conceal his conflicts of interest with his corporate positions at De Rance. [See paragraphs 110 to 119 and 145 to 152]

57. Defendant's wife (plaintiff Erica P. John) refused to sign a joint return for 1984 because she had discovered after October 5, 1984, that defendant had one or more foreign accounts. Mrs. John advised defendant's tax preparer, Robert Schweitzer, of her belief. When Schweitzer questioned defendant specifically about any foreign accounts, defendant deliberately lied to Schweitzer by denying the existence of his accounts in Mexico, Liechtenstein, and the Cayman Islands. [Testimony of Mrs. John, Robert Schweitzer]

Perjury: Counts #1-3

58. On three occasions in his deposition on January 12, 1985, denied or didn't recall any personal gold investments with Paine, Webber, Jackson stock brokerage firm. (H. G. John Dep. Tr., p. 9)

59. Defendant's answers were all false material statements, while under oath, which he knew were not true. [Ex. 395-407; Sarnoff Dep. Tr. 4/8/86, p. 36]

Perjury: Counts #4-8

60. In a deposition taken April 3, 1986, in the related case of *De Rance v. Paine, Webber and Paul Sarnoff*, defendant twice denied having a personal account with Paine, Webber Jackson stock brokerage firm, twice denied having a personal account with a bank in Liechtenstein, and once denied attempting to borrow $50,000 from Paul Sarnoff who managed his account with Paine, Webber. [H. G. John Dep. Tr., p. 238]

61. Defendant's answers were all false material statements, while under oath, which he knew were not true. [Ex. 395-407, Sarnoff Dep. Tr., p. 8-71]

Perjury: Counts #9-11

62. At the trial of this case on May 15, 1986, defendant denied having a personal gold futures account with Paine, Webber Jackson stock brokerage firm, denied having

directed the Liechtenstein bank to send defendant's funds to Paine, Webber in New York with the account being named "Quorum Anstalt", and denied being in touch with Paul Sarnoff periodically on the status of the account. [H. G. John Tr., p. 27 and 36]

63. Defendant's answers were false material statements, while under oath, which defendant knew were not true. [Ex. 395-407, Sarnoff Dep. Tr. 4/8/86, p. 8-71]

Perjury: Count #12

64. At this trial on July 30, 1986, defendant was asked the following question and gave the following answer: [H. G. John Tr., p. 6]

Q. Did you tell the board you had a money manager in Liechtenstein?

A. Oh, yes.

65. Defendant's answer was a false material statement, while under oath, which defendant knew was not true. [Testimony of Mrs. John, Dr. Gallagher, and Robert Schweitzer]

Perjury: Count #13

66. At this trial on May 27, 1986, defendant was asked the following question and gave the following answer: [H. G. John Tr., p. 66]:

Q. Did you ever advise the board of directors that you had stock in the or had investments in the same Mexican mutual funds that the foundation was in?

A. I don't think I did.

67. At this trial on July 30, 1986, defendant was asked the following question and gave the following answer: [H. G. John Tr., p. 6]

Q. And what about the Mexican mutual funds? Did you

tell the board about that?

A. Yes.

68. Defendant's testimony on July 30, 1986 (preceding paragraph) was a false material statement, while under oath,

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APPENDIX F

STATE OF WISCONSIN : CIRCUIT COURT
MILWAUKEE COUNTY

ERICA P. JOHN, as an Officer and Director of DeRANCE, INC., a Wisconsin Non-Stock, Non-Profit Corporation, et al.,	Case No. 650-555
Plaintiffs,	(Beginning of Day) Volume I
vs.	
HARRY G. JOHN, as an Officer, Director, and Trustee of DeRANCE, INC.,	
Defendant.	

April 17, 1986 Before the
HONORABLE MICHAEL J. BARRON
Circuit Judge, Branch 8,
Presiding

APPEARANCES: SMITH & O'NEIL, S.C., by
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For the Plaintiffs

CANNON & DUNPHY, by
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For the Plaintiffs

SUTTON & KELLY, by
Robert E. Sutton and
Walter F. Kelly
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For the Defendant

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* * * *

EXHIBITS

		Volume I		
Number	Description	Marked	Offered	Received
1501	Curriculum vitae-Julian Nava	7	9	9
1502	*Who's Who in the World* designation	7	9	9
1503	*Who's Who in America* designation	7	9	9

testify about. I would like to put him on the witness stand and introduce his testimony. Then they can make whatever arguments they want.

THE COURT: It's been a while since I've taken a look at that.

This is on the real party interest?

MR. SUTTON: Yes, Your Honor.

THE COURT: Well, how long is this testimony going to take, Mr. Sutton?

MR. SUTTON: Fifteen minutes.

THE COURT: All right, let's take the testimony.

MR. SUTTON: We call Julian Nava to the witness stand.

(Whereupon, Exhibits Number 1501 through 1503 were marked for identification.)

JULIAN NAVA,

being first duly sworn oath, testified as follows:

DIRECT EXAMINATION

BY MR. SUTTON:

Q For the record, sir, what is your name?

A Julian Nava.

Q And your address?

A 18308 Septo Street.

THE COURT: S-E-P-T-O?

THE WITNESS: Correct.

A Northridge, California.

Q Can you get a little closer to the microphone.

A Yes.

Q And how are you employed, sir?

A I'm a professor of history at California State University, Los Angeles, California, and a self-employed consultant as well.

Q Where did you attend high school?

A Roosevelt High School in Los Angeles.

Q And where did you attend college?

A East Los Angeles Community College for the Associate of Arts degree, Pomona College for the Bachelor of Arts degree, and Harvard University for the Ph. D.

Q And when did you obtain a Ph. D. from Harvard University?

A In 1955.

Q And after 1955 how were you employed?

A I first taught at the university level at the University of Puerto Rico in Puerto Rico for two years.

Q And then? -

A And then I went to the university—the State University of California at Northridge, where I have been since then except for other interludes like one year as a State Department professor, Fullbright Professor in Spain, a subsequent experience as a founder of a university in Bogota, Columbia, then subsequently U. S. Ambassador to Mexico under the Carter administration and the beginning of the President Reagan administration.

Q What subject do you teach?

A History.

Q Now, I show you what has been marked Exhibit 1501, 1502, and 1503. Exhibit 1501 is a curriculum vitae with respect to your career; is that correct?

A Yes.

Q. And 1502 the designation that you are in *Who's Who*; is that correct?

A Yes.

Q As is— *Who's Who in the World*, I'm sorry.

A Correct.

Q And 1503 is the designation that you are in *Who's Who in America*; is that correct?

A Correct.

MR. SUTTON: I would offer into evidence for the Court's consideration those exhibits.

THE COURT: They're all received.

Q When did you receive your credentials as ambassador to Mexico?

A Early in 1980.

Q And how long were you the ambassador in Mexico?

A During 1980 and the beginning of 1981.

Q And you were succeeded by Mr. Gavin (phonetic); is that correct?

A Ambassador Gavin; correct.

Q Now, would you for the record advise what the functions of an ambassador to a foreign country are.

THE COURT: I think I know what they are, but go ahead.

MR. SUTTON: Oh, you do, Your Honor? Well, maybe you do.

THE COURT: Maybe you want to make a record.

MR. SUTTON: I want to make a record of what they are.

A Among countries that have agreed to certain conventions and international agreements, which is most of the civilized world as we call it, an ambassador personally embodies the authority of his chief of state in all respects in the host country to which he is assigned and relates to the chief of state and the official governmental bodies in the host country by virtue of that authority.

Q Now, under the conventions which obtain and the policies that govern the functions of an ambassador, would you advise what restrictions are imposed upon the ambassador with respect to his dealings with the citizens of the host country.

A Well, an ambassador is precluded very precisely by international agreements and conventions from relating to the citizens of the host country in any manner other than purely informal or social so as to avoid even giving the impression that his authority as a representative of a chief of state is being used to influence the local, political, social, economic, personal life of the citizens of the host country.

Q Now, you have read, have you not, the depositions of the testimony of Mrs. Erica John and Donald Gallagher with respect to meetings which they had with Archbishop Pio Laghi, who is the ambassador from the Vatican to the United States?

A Yes.

Q Do you have an opinion— Do you have an opinion, Ambassador Nava, as to whether the suggestions made by Archbishop Pio Laghi were appropriate property to come under the conventions of ambassadors from foreign countries?

MR. WILLIAM CANNON: Objection—no foundation. He hasn't established what the protocol agreements are between the Vatican and the United States. It also is the time frame.

THE COURT: Well—

MR. WILLIAM CANNON: It's also immaterial.

THE COURT: I'm going to take if for no other reason to make sure that Mr. Sutton can establish his record. As concerns the issues relating to what conventions and/or treaties exist between the United States and the Vatican, I don't think that that's necessary to be introduced in order for this gentleman to form an opinion as to what restrictions are placed upon somebody like the archbishop.

So you can give you opinion.

A Well, the answer was yes, I'm sorry.

Q You do have an opinion?

A Yes.

Q And what is that opinion?

A My reading of the sworn deposition is that Ambassador Laghi grossly exceeded the accepted norms and practices for the exercise of his authority as an ambassador to the United States.

Q Now, are there any circumstances unique to Ambassador Laghi's status.

MR. WILLIAM CANNON: Objection—no foundation.

MR. SUTTON: As an ambassador.

THE COURT: Would you read that question back.

Q In other words, as compared to other ambassadors from other political entities or countries in the world, is there anything unique about the status of Ambassador Laghi?

MR. WILLIAM CANNON: Objection—no foundation.

THE COURT: Overruled. You may answer.

A He is the first ambassador from the Vatican to the United States in our 200 years of independence. He is also unique in that he represents not only what is recognized to be a sovereign state, but he is the absolute head of a theocracy or a world church such that his authority is dual. He has a spiritual and moral overwhelming influence on anyone who professes to be a Catholic in such a way that unlike a usual ambassador, any statement that he would make to a fellow Roman Catholic would have

the unvadable (phonetic) connection with his authority as a personal representative of the Holy Father, and that is the reason for why the United States down to this administration has respectfully not granted repeated requests from the Vatican for the designation of the Pope's ambassador—for the designation of the Pope's representative—to the United States as or with the rank of ambassador.

Q And, finally, Ambassador Nava, what are the remedies available to a citizen of a host country who is aggrieved by the wrongful interference of an ambassador from a foreign country?

MR. WILLIAM CANNON: Objection. That calls for a legal conclusion. There's no foundation.

THE COURT: Sustained.

Q Well, as an ambassador, is it not true, Ambassador Nava, that one of the things that you are counseled on is the remedies that citizens of foreign countries have—or that citizens of host countries have—against actions—improper actions—by ambassadors?

A Correct.

MR. WILLIAM CANNON: Same objection and hearsay.

THE COURT: He's asking for an opinion rather than—

MR. SUTTON: I'm qualifying him to give this opinion.

Q When you became an ambassador to Mexico, you were schooled in that, were you not?

A Yes.

MR. WILLIAM CANNON: Same objection.

THE COURT: I'm going to take it for whatever it's worth.

MR. SUTTON: Okay.

Q Tell us what the remedies are for a citizen aggrieved by the wrongful interference by the ambassador from a foreign country.

A It's the converse side of the limitations placed on an ambassador with respect to the citizens of the host

country.

Q Oh, yes, I'm sorry. That's what I should have led into it. What is the— What right does an ambassador have that is unique with respect to immunity from process in the host country?

MR. WILLIAM CANNON: Same objection—legal conclusion.

THE COURT: Let him answer it.

A Ambassadors are fully informed regarding their rights and their responsibilities in light of their function, and they are informed, as I was, that I could not, as an individual, in the country to which I might be assigned, take legal action against a citizen or an institution in that host country, but must deal exclusively through the host government in light of the function of the ambassador. Conversely, a citizen in the host country who has any imagined complaint or supposed, alleged complaint against an ambassador relates through their own government in order to lodge a complaint against the ambassador because he is a representative of a foreign state.

MR. SUTTON: And the three branches of government in the United States which I'm sure the Court can take judicial knowledge of are the judicial— the legislative, executive, and judicial.

MR. SUTTON: That's all.

You may cross-examine

THE COURT: Cross-examination.

CROSS-EXAMINATION

BY MR. WILLIAM CANNON:

Q Mr. Nava, the first person that you met concerning anybody that was involved with this litigation was Professor Jauregui; is that correct?—seated in the gray suit here.

A Correct.

THE COURT: Excuse me, how do you spell that—

MR. THOMAS CANNON: J-A-U-R-E-G-U-I.

Q And Mr. Jauregui, after talking with you on that first

occasion, explained to you the difficulties that Harry John was encountering, didn't he?

A Not on the first occasion that we met.

Q Okay. Well, there was a second meeting in which you were taken by Mr. Jauregui to the home of Attorney Thomas Jeffers seated in this courtroom; isn't that true?

A Yes.

Q And at that meeting you discussed the problems that infighting among the people, the various factions and groups, et cetera. And that's what the scandal was about—at least as far as what Mrs. John testified. She said he was very concerned about all the reports that he had been hearing and all the—the fact that the foundation was close to bankruptcy and that—I don't know if he used the word "bankruptcy," but that the foundation was in deep financial difficulty, and said he was very sorry to hear that because it was such a great loss to the Church. And also what could we do to reduce expenses and to reduce the—to put the old foundation and Santa Fe in good financial basis without causing scandal. That was one of the things that was recurring in his sentence, very much that he was—he didn't want to have this scandal in the open because it would be detrimental to the church.

"Question: What did he refer to as a scandal? What did he refer to as a scandal?

"Answer: The way things were going on in Hollywood.

"Question: What things?

"Answer: There was a lot of waste of money."

That's the scandal that they were talking about. And what was mentioned in the depositions, and this gentleman, whether he was or was not interfering with the domestic affairs of the United States, and the message and the talks that he had with Mrs. John and with Mr. Gallagher is really irrelevant. The real question is who is the real party in interest. There's no way from the deposition that I've seen that either the Vatican, Archbishop Pio Laghi, or the Roman Catholic Church is the real party in interest in this case. The real party in

interest are the two plaintiffs who are the board of directors and pursuant to Wisconsin law have the right to do what they did, and that is to start a lawsuit against Mr. John in hope that the Court is going to see it their way with evidence that they want to produce to oust Mr. John from his position as trustee and director. There's no way that I got any conclusions from these two depositions that either of the three parties that were named by Mr. Sutton in his motion were the, quote, real party in interest in this case. They have an interest, no question. And there's no question that because of the philosophy of Harry John and the DeRance Foundation over a period of years, is to primarily support Catholic causes. That's right in the articles and by-laws. And anyone who is a potential beneficiary of that largess and grants would be concerned as well, and I don't see any reason why someone in Mr.—Archbishop Pio Laghi's position wouldn't be any more concerned than anyone who is a potential beneficiary of DeRance Foundation whether it's run by Harry John or Mrs. John or anyone else. So whether or not he violated the ambassador's code as so testified to by former Ambassador Nava to me is irrelevant.

MR. SUTTON: Well, that's what I wanted to address. That vast testimony indicated that the redress, if he did, is by the host government, which you are. You are the judiciary of the host government, and if— I believe that you are compelled to rule not only whether they're the real party in interest, but whether Ambassador Nava's—or Ambassador Pio Laghi's interference was wrongful and, if it was, you must also dismiss the case for that reason.

THE COURT: There's no way, I mean— That's about as far off the wall argument as I've heard in the 13 years that I've been on the bench, Mr. Sutton.

MR. SUTTON: So I presume you'll deny it?

THE COURT: Yes, and I congratulate you on your innovativeness, but I'm not buying it.

Now, lets get to the next motion.

MR. WILLIAM CANNON: If it please the Court, the next motion is our renewal of our consent motion against Mr. John with respect to the production of discovery documents. Again, we've had five discovery

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APPENDIX G

STATE OF WISCONSIN : CIRCUIT COURT
MILWAUKEE COUNTY

ERICA P. JOHN, as an Officer and Director of DeRANCE, INC., a Wisconsin Non-Stock, Non-Profit Corporation, et al.,	)	Case No. 650-555
Plaintiffs,	)	Volume II
vs.	)	
HARRY G. JOHN, as an Officer, Director, and Trustee of DeRANCE, INC.,	)	
Defendant.	)	

July 16, 1986 Before the
HONORABLE MICHAEL J. BARRON
Circuit Judge, Branch 8,
Presiding

APPEARANCES: SMITH & O'NEIL, S.C., by
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For the Plaintiffs

CANNON & DUNPHY, by
William M. Cannon
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310 West Wisconsin Avenue
Milwaukee, WI 53203
For the Plaintiffs

SUTTON & KELLY, by
Robert E. Sutton and
Walter F. Kelly
1409 East Capitol Drive
Milwaukee, WI 53211
For the Defendant

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Q And about how long have you known Harry John?
A I'm 64. Harry is 66. He was two years ahead of me in grade school.
Q Now, I direct your attention to a period after October 5, 1984, which was when this lawsuit was commenced by Mrs. John and Dr. Gallagher against Harry John. In November or December of 1984, did you have occasion to have a telephone conversation with Mrs. John about the lawsuit.
A I'd change that. I'd say any conversation I had with Mrs. John was about maintaining their marriage and their family.
Q Okay. What did she tell you about the—starting the lawsuit?
A She said that her advisers in Rome had said she was

under pain of grievous sin—

MR. WILLIAM CANNON: Well, I'm going to object with respect to hearsay conversation.

THE WITNESS: Sure.

THE COURT: It's not hearsay. This is the plaintiff.

MR. WILLIAM CANNON: She's talking about her advisers in Rome.

THE COURT: This comes right from the plaintiff herself.

A —that she was under pain of grievous sin if she didn't start a suit against her husband.

Q Okay. Now, what have you observed with respect to Erica John over the past three years with respect to her being concerned about Mr. John marrying a younger woman and starting another family?

MR. WILLIAM CANNON: Objection—immaterial. I mean, if we're going to get into this, then what's good for the goose is good for the gander.

MR. SUTTON: Okay. Well, under that threat I'll withdraw the question.

You may cross-examine.

CROSS-EXAMINATION

BY MR. WILLIAM CANNON:

Q Would you agree that Mrs. John has always been a person who has devoted herself to the best interests of the DeRance Foundation?

A I believe that.

Q And would you agree that all the decisions that she's made with respect to the DeRance Foundation have been made with respect to wanting to do what is best for the foundation?

A She may feel that what she's done is best for the foundation.

Q And, as far as you know, all of her actions were done in

APPENDIX H

STATE OF WISCONSIN : CIRCUIT COURT
MILWAUKEE COUNTY

ERICA P. JOHN, as an Officer and Director of DeRANCE, INC., a Wisconsin Non-Stock, Non-Profit Corporation, et al.,	)	Case No. 650-555
Plaintiffs,	)	Testimony of WALDEMAR A. NIELSEN
vs.	)	
HARRY G. JOHN, as an Officer, Director, and Trustee of DeRANCE, INC.,	)	
Defendant.	)	

July 28, 1986 Before the
HONORABLE MICHAEL J. BARRON
Circuit Judge, Branch 8,
Presiding

APPEARANCES: SMITH & O'NEIL, S.C., by
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For the Plaintiffs

SUTTON & KELLY, by
Robert E. Sutton and
Walter F. Kelly
1409 East Capitol Drive
Milwaukee, WI 53211
For the Defendant

PROCEEDINGS

MR. SUTTON: Defendant would call Mr. Waldemar Nielsen.

THE CLERK: Do we have another appearance here today?

MR. WILLIAM CANNON: This is Mr. Slocum from Kaplan & Driesdale in Washington, D. C.

THE CLERK: What is the first name?

MR. WILLIAM CANNON: Walter.

THE CLERK: Thank you.

WALDEMAR NEILSON,
being first duly sworn on oath, testified as follows:

DIRECT EXAMINATION

BY MR. SUTTON:

Q Again for the record, sir, what is your name?
A My name is Waldemar Neilsen.
Q And your age?
A My age is 69.
Q And your address?
A 15 East 91st Street, New York City.
Q And what is your occupation, sir?
A I am a writer and a private consultant.
Q Now, I would like to— What city in the United States were you born and raised?
A Well, I was born in Greensburg, Pennsylvania. I grew up in Detroit, Michigan.
Q Where did you attend college?
A I attended the University of Missouri, Oxford University very briefly, University of Wisconsin.

Q Now, the University of Missouri. what degrees did you obtain and when?

A I got two undergraduate degrees—an A. B. in economics and a B. S. in business administration in 1939. And I got a Master's Degree in political science in 1940 at the same university.

Q At the University of Missouri?

A Yes.

Q And did you receive a Rhodes Scholarship?

A I did.

Q And when were you— When did you receive that honor?

A I received that in— It seems strange. It's so long ago. I think I received it in 1939 to go to Oxford in 1940, beginning of 1940.

Q Okay. And what were the circumstances, then, of your attending Oxford on that—

A The war had broken out in 1939, and Oxford just about the time I got there was being converted into an RAF training center so that regular classes were not being conducted, and after just a little more than a month, I turned around and came back, and the University of

A Well, the foundation fell into rather serious organizational difficulty rather quickly because Mr. Hoffman decided to work practically full time for the election of General Eisenhower as president, and the board then removed him as president, transferred the headquarters of the whole thing back to New York, named the new man as president, and the new man asked me if I would work with him as his general executive assistant.

Q And who was that?

A That was a man named Gaither, G-A-I-T-H-E-R.

Q So you— The president of the Ford— You were the president of the Ford Foundation's executive assistant?

A Yes.

Q For what years?

A As I recall, '54 and a good part of '55.

Q And what type of work did you do as his executive assistant?

A Well, executive assistant work, that is, all manner of administrative and program matters and relationships with the board and with the Ford Motor Company.

Q And did you become familiar with the organizational structure of the foundation?

A Indeed, I did, yes, and the workings of the board and the very delicate and complicated relationships between the foundation and the motor company and the family.

I think that was in 1956. And thereafter, when the investigations had been completed and when the foundation had been exonerated, then I was named as the director of the international programs of the foundation

Q The international programs of the Ford Foundation?

A Yes.

Q All right. And where and what countries of the world were you involved in implementing the international programs of the Ford Foundation after 1956 and for what period of time?

A Well, I was for a year or so primarily involved in programs in third world countries and among those primarily India and Pakistan, and then about 1958, I believe, my area of concentration became Western Europe, and it was in Western Europe that I worked essentially from then until I left the foundation.

Q Were you involved with the allocation of funds, expenditures, and grants of the Ford Foundation to whatever charities in Western Europe they determined were appropriate beneficiaries of foundations?

A I was. And also with American organizations working on international affairs, the consul on foreign relations, various university programs dealing with international matters.

Q Now, as the head of the African American Institute, did you have any interaction or interrelation with any foundations in the United States?

A Indeed. We were dependent in our funding at the institute

partially on government contracts, partially on individual contributions, and partly on foundation grants, and so I had—I spent a considerable part of my time working with foundations to obtain their funding for various of our programs.

Q And what foundations did you become familiar with or did you act with during that period of time?

A Well, the ones that primarily I worked with were the Ford Foundation, the Carnegie Corporation, the Rockefeller Foundation, the Rockefeller Brothers Fund, the Andrew W. Mellon Foundation. Those would be the principal ones.

Q Now, in 1972 you published a book called *The Big Foundations*?

A I did, yes.

Q Would you tell the Judge how you came to write *The Big Foundations* and what the subject matter of *The Big Foundations* is.

A Judge, in the course of my years both on the grant-giving side of the table with the Ford Foundation and the grant-seeking side of the table with the African American Institute, I became deeply interested in philanthropy in the United States and convinced of its very special and very important role in our national life, but I also became very disappointed by what seemed to me to be the many deficiencies of the major American foundations, and I had tried during my years as a professional foundation person to talk with my colleagues in the business, so to speak, about some of the very obvious reforms that were needed. For example, in those days, very, very few foundations, including the very large ones, published reports about their activities. There were many problems of the utilization of foundations to maintain donor control over profit-making companies. There were some very serious cases of nonpayout of money to charity, and although I and others in foundations talked about these things, really nothing happened, and instead the standard kind of writing that was being done about foundations was sort of self-congratulatory writing, and I—I felt that perhaps one small contribution I could make to the

improvement of foundation performance was to try to write a book that was balanced, but candid, about both the achievements of philanthropy, which are many and important, but also about the faults and failures of foundations, which particularly in that period were many and very serious.

Q All right. So what was the subject matter, then, of *The Big Foundations*?

A Well, I took the— I forgot how much it was now, but I took about the 35 I think at that time—at that time had a hundred million dollars or more of assets, and I tried to do case studies of each one about its origin, its programs, my evaluation of its achievements and deficiencies, and then I tried in the introductory and closing chapters to generally talk a little more broadly about American philanthropy and its role and prospects.

Q And was that book commissioned by, ironically enough, a foundation itself?

A Indeed. It was commissioned by a small foundation, the 20th Century Fund.

Q And in the course of the preparation of that book, did you research into the histories of foundations and the background and personalities of the founders and the founding families?

A Oh, I spent virtually all of my time, including Saturdays and Sundays, for three years talking to foundation people, talking to people that had dealt with foundations, digging into the research materials that were available, and, yes, I gave myself a considerable education in philanthropy in that period.

course, in my years in philanthropy. Seriously, the book provoked a great deal of discussion, and it provoked a number of rather significant changes and reforms in some of the foundations that I had discussed. But, as far as my major activities are concerned, I by then had left the African American Institute and had decided to devote most of my time to writing and to some consulting. The consulting work grew very rapidly. That was a period of

considerable social activism in the United States with regard to affirmative action and environmental problems and so on, and so I set up a consulting company to deal with those problems, and those have been my main activities since—writing and consulting and advising.

Q Now, did you write a sequel to *The Big Foundations*?

A I did. That came out the end of last year, yes.

Q And the name of that?

A It's called *The Golden Donors*.

Q All right, I show you what has been marked Plaintiffs' Exhibit 1720 and ask you if that is a copy of *The Golden Donors*?

A It closely resembles it, yeah.

Q Well, is it?

A It is.

Q Okay. The law is precise, Mr. Neilsen. Now, between 1972 and 1985 have you had occasion to be consultant to any individuals or foundations?

A Yes.

Q And can you relate some of the examples of what foundations and founders you have acted in the consulting capacity?

A Well, the list of foundations is quite considerable. They usually are consulting services on a particular program or a particular problem. I've been a consultant of the Ford Foundation and the Rockefeller Brothers Fund and a good many of the large foundations. I've had a more substantial advisory role with regard to the Hall family foundation in Kansas City.

Q Is that the Hallmark Card—

A That's the Hallmark Card— Well, it's the family of the founder of the Hallmark Card Company. And I have had a strong and continuing role in the development of the Atlantic Richfield Foundation—Atlantic Richfield Company Foundation.

Q Did you know Mr. John Paul Getty?

A Well, I have advised a number of quite wealthy individuals about their philanthropy and, yes, those would include J. Paul Getty for a two-year period, John

D. Rockefeller III for several years, Robert O. Anderson for quite a number of years.

Q That's the Atlantic Richfield Company?

A He's the— Yes, he was the founder of Atlantic Richfield.

Q During the period of time that you advised Mr. Getty, was that in England?

A That's when he was living in England and when he was trying to decide what kind of a foundation with what purposes that he would try to establish.

Q So you said the Ford family, John D. Rockefeller III, Mr. Getty, the gentleman from Atlantic Richfield. Any others that—

A Well, I was an adviser for four or five years. I'm just thinking of prominent individuals that might be readily identified—to the shahbanou of Iran, the wife of the shah, who had very large, charitable, and philanthropic activities under her direction, and I served as an adivser for a couple of years to her in organizing and activating those programs.

Q To return for a moment to *The Golden Donors*, subtitle *The Golden Donors, A New Anatomy of the Great Foundations*, would you describe what additional research you did in connection with the preparation of that publication and how it is modified from *The Big Foundations*.

A Well, I intended, actually, simply to do a rather brief

A I have served, and I periodically serve, on the investment and finance committee of the Home Insurance Committee. In the case of the *Observer*, the board functions as a committee of the whole, and we deal as board members with all financial matters as well as other matters.

Q Now, during your research for *The Golden Donors*, which is marked for identification as Exhibit, I believe, 1720, did you have occasion to come across any information with respect to the DeRance Foundation in Milwaukee, Wisconsin?

A I did. I had originally the idea that I would again try to

deal with all the American grant-making foundations that had a hundred million dollars or more of assets. As I got into my research, I realized that for various reasons, including inflation, the number of foundations in the United States with assets of a hundred million dollars or more was so great that there was no way to deal with them all in one book. So I had to change my cut-off level to $250 million. But in that preliminary research period, the DeRance Foundation was one of those that I took a good look at because its assets were in that hundred-million-plus range.

Q And what information did you avail yourself of in connection with your investigation or research of the DeRance Foundation?

A Well, I went through all of the tax returns of the foundation. The tax returns as you know, I guess, include listing of the officers and their salaries, the administrative costs, all the investments, all the grants individually, that the foundation has made. I also, as I recall, I wrote to the DeRance Foundation with a long list of questions, and I received no reply. However, in the research files of the Foundations Center—

Q What is the Foundations Center?

A Oh, the Foundations Center is a nonprofit agency created after the 1969 Tax Act was passed which maintains open publicly available files about really every foundation in the United States over minimal size. They publish a whole range of very informative directories about foundations, and there are branches of the Foundations Center which have the same material throughout the country. I think there are 12 or 14 branches of the Foundations Center. My reference to it, I believe, is the headquarters operation in New York which has had a—

Q And did you utilize those archives in the preparation very much?

A Had those archives not have existed, it would have been simply impossible to do a look like that.

the study of the DeRance materials with a slight feeling

of annoyance that they hadn't provided the information that I had requested, but it was a purely personal matter. Three or four major characteristics that come through very clearly about the DeRance Foundation were these: number one, it had a very broad and ambitious scope to its program. A great majority of the largest American foundations have essentially a local or a regional focus in their activities. Only a minority undertake to address national problems, and hardly a handful have significant international programs. The DeRance Foundation clearly has a program really global in scope.

Q I'm sorry, I didn't here the last— Global?

A Yeah, global in scope. And that is a clear and distinctive and positive factor in my judgment.

Q Why is that a positive factor in your judgment?

A I believe that it's very important that foundations address different things and different problems, that some work on health problems, and some work on educational problems, and likewise, I think that because there are some great issues in the world that are not only humanitarian issues, but that affect our lives here in the United States, I think that it's very valuable and useful that at least some foundations attempt to address those large world-wide problems, while other foundations are concentrating essentially on local or regional or national problems.

Q What are the major characteristics that you discerned?

A The first was the global scope of its program. The second thing was the particularly humane quality, you might say, about its program.

Q How did you determine that?

A Well, it has, in a large proportion of its grants, a focus on the poor, the needy, the vulnerable, lepers, the aging, in a number of the poorest regions of the world.

Q Is that not a mark of the standard foundation in the United States?

A No, indeed. There are some foundations that address those, but on the whole foundations tend to work, you might say, at the upper end of the scale, with the more

prestigious universities, with the more established hospitals, the more established research centers, and again I don't condemn or criticize that, but I do emphasize that the DeRance Foundation seemed to focus on the kind of human problems around the world that the vast majority of foundations, including the large foundations, do not address.

The third characteristic that struck me very forcefully about the DeRance foundation was the—you might say the modesty of the foundation in blowing its own horn. I have long advocated that foundations make information available publicly about their activities, and the '69 Tax Act now, of course, requires that of them, but there are some that devote a great deal of effort and expenditure to publicizing their own good works. DeRance hardly—hardly publicizes its activities at all.

Q Is ther a foundation called the Gannett Foundation, G-A-N-N-E-T-T?

A The Gannett Foundation.

Q Gannett Foundation?

A Yes.

Q From the newspaper publishing?

A Yeah, it's a rather new, large, and very good foundation, but I suppose in the tradition of a media oriented institution, they—they publish dozens, probably hundreds, of press releases every year in communities all over the United States about the grants they make.

Now, the fourth thing I guess I would mention is that the DeRance Foundation has operated with an extraordinarily small staff and low administrative cost, and that the donor is, or has been, was, much more

questions, deliberately spending themselves out of existence. Is the concept of total exhaustion of the resources of a private charitable foundation a recognized and acceptable aspect of philanthropy in the United States?

A Indeed, it is. Most of the large foundations have been established to operate presumably in perpetuity, and

that is permitted under the law. But there is a strong, you might say secondary, point of view or philosophy about philanthropy that—which holds that foundations should not be established and operate in perpetuity because if they do, they tend to become more and more bureaucratized and more and more sclerotic as the generations pass and as the donor and donor family recede more and more into the past, and one of the very greatest American philanthropists, a man named Julius Rosenwald of Chicago, Sears Roebuck, a man who made an enormous contribution to race relations in the United States back in the 1920s, he held very strongly the view that a foundation should be created and operate only for a limited period of time. He thought 20 or 30 years partly because he felt that the donor's direct hand in the administration of a foundation was a very important and positive factor, and he did himself personally involve himself actively in his foundation, but the

Q And the danger of the foundation using grants to influence elections?

A Well, the best of my recollection, from the grant lists that I read over, it doesn't seem to me that any of them were of that character.

Q And I believe the other one was operating foundations as distinguished from grant-making foundations?

A That isn't relevant because this is and has always been, as I understand it, a grant-making foundation.

Q Now, commencing sometime in 1981 and continuing through 1984, DeRance became involved—actively in—if not substantially funding completely—funding the capital outlay expenditures for the establishment and development of a national Catholic television network. From your experience in the area of foundations and your study of foundations, do you have an opinion, to a reasonable degree of certainty in the area of private charitable foundations, whether such an enterprise was suitable for a private charitable foundation?

MR. WILLIAM CANNON: Again I'm going to

object, Judge, on the basis that it's immaterial because there's no issue in this lawsuit. We aren't contending that it wasn't suitable to go into that area.

THE COURT: I understand. But I'm going to let him answer anyway. It would be superfluous.

A It's entirely appropriate for foundations to work in the field of television and communications, and an increasing number of very prominent foundations are, in fact, moving into that field now.

Q Can you give some examples of foundations that have in the past ten years or twenty years become involved and, in fact, redirected the focus of their foundation into the media—into television particularly?

A Well, the Carnegie Corporation funded a major study that led to the enactment of the federal law creating the public broadcasting system, and since then they have made major grants for the children's television workshop, Sesame Street, programming. The Annenberg Foundation in Philadelphia has made major grants for the support of schools of journalism and mass communications, the Gannett Foundation doing the same. The Ford Foundation has made really massive grants for 15 years or more to generally strengthen the public broadcasting system in this country. The Mellon Foundation has been a major supporter of national public radio. There are— I needn't go on. There are quite a number of very prominent and respected foundations that have moved into this field because of what they consider its educational potentiality or its social usefulness or whatever.

Q Now, using the time frame of the last 15 years, the asset portfolio of the DeRance Foundation appreciated from approximately—the sale price of the stock owned by Mr. John's sister, which was approximately the same amount he had, was $35 million, sometime in the late 60s, and he sold his stock—or the foundation sold its stock for $97 million, I believe it's '74, and that investment—and invested it with First Wilshire as money managers in '77, and the portfolio grew—appreciated in market value to

a hundred and eighty-three million by 1983, and in that period they had also distributed a hundred and twenty-five million. What is that, from your knowledge and study of foundations over that period of time, how does that appreciation compare with the appreciation or depreciation of other major foundations, particularly the Rockefeller and Ford Foundations, over that same period of time?

A I would say that there is not a single foundation in the list of some 35 major foundations in my book, *The Golden Donors*, that have had a percentage increase in the value of their corpus as great as the DeRance Foundation.

Q Now, over that period of time, what is your observation of the philosophy of philanthropic foundations from the standpoint of conservative or liberal investment

you take the case of deceased donors, as part of that general policy of encouragement to philanthropy and charity, the greatest respect in the law is accorded to the stated wishes of the donor. I've been a witness in the Buck Trust case in San Francisco, which was just settled this week as you know, in which the deceased donor's requirements in her will were very strongly supported by the court.

THE COURT: Is that the Marin County case?

THE WITNESS: The Marin County case.

A Probably the Duke Endowment is a particularly vivid example. A very important donor in the Carolinas who died some 50 or 60 years ago, I believe—

Q The tobacco magnet?

A The tobacco magnet—James Buchanan Duke—and his will creating his foundation was very, very specific. He not only identified exactly which institutions should forever get the benefits of—the gifts of the endowment, but he specified exactly the purposes for which those gifts should be made, and he gave a list of the precise percentages down to a decimal point of how much of the income of the endowment each year should go to each one of the specified grantees. The trustees a few years

ago went to the court to ask for a modification, a slight modification, in some of those requirements, which the court refused to give, and I cite that simply to indicate that in American law and American tradition, it is considered very important, in order to sustain the tradition of giving to charity and philanthropy, to give donors the assurance that what they specify in their wills in turning their money over to philanthropy will be respected and adhered to long after their death. Now, there is a cy pres—

THE COURT: C-Y-P-R-E-S.

A —doctrine which everyone is familiar with. In certain circumstances the Court will permit some limited modification of a donor's expressed purposes. But in any case the central point is that for deceased donors, the American tradition is that he or she can lay down very broad—within a very wide scope—exactly what they want their bequest to be used for, and the courts respect that, and that is considered to be a central element in sustaining this willingness of donors to give to charity.

Now, if we take the case of a living donor, we know that a foundation begins with a donor. The donor decides to create the foundation. He decides as to what its purposes will be. He decides what its mode of operation will be, that is, whether an operating foundation or a grant-making foundation. He decides what kind of governance mechanism the institution will have, and he most commonly names personally the individuals who will make up the initial board of that foundation.

Now, it is my understanding from my research—and I don't presume to speak as a legal authority, but simply as one familiar with the American tradition of philanthropy and the practices of foundations—that after the donor—the living donor—creates his foundation and names his trustees and establishes a set of by-laws under which that foundation will operate, obviously the money is no longer his in any personal sense, and he can be outvoted by his trustees if that is their determination. However, the practice is, and the line is very clear and

consistent, that most donors are really quite careful to select as the trustees of their foundation individuals that they feel share fully and wholeheartedly their purposes in creating the foundation and who will be at least compatible if not reliably responsive to the donor's wishes in the direction and management of the foundation. Now, I'm not talking here about corruption or nonfeasance by the trustees in those situations, but I am suggesting that a person who accepts appointment on the board as a trustee of a donor's foundation does so if he does--if he accepts the appointment in good faith—does so with an agreement with the donor's wishes as to the purposes and character of the foundation, and the typical pattern is that if a trustee as some point feels that he can no longer go along with the donor in some program matter, the pattern is that out of respect for the donor, out of respect for the fact that this is the person who provided the resources and created the institution in the first place, his option in that case is to resign from the board. And I am not familiar, from my research, with any case like the present one in which the other trustees, instead of resigning when they found themselves in some basic disagreement with the donor, instead attempted—or are attempting, I guess, to oust the donor from his own foundation. I suggest if it's appropriate—

MR. WILLIAM CANNON: Well, if it please the Court, first of all I'd move to strike the last portion of his statement as immaterial to the issues in this lawsuit; and, secondly, I think it's getting into a narrative response here.

Q What is your opinion as to the impact of that—

THE COURT: Would you like me to make a ruling?

THE WITNESS: I would appreciate it, yes.

think in all respects accurately reflects what the testimony has been.

THE COURT: That's the fact. When the opinion becomes worthless. Be he is asking the witness to assume those facts in giving his opinion, and the objection is

overruled.

A In the most basic terms there is nothing wrong whatever, and there may be something very right depending on the case of a foundation putting all of its resources into some enterprise that is very strongly believed in. So that's the first point.

Second point is whether Mr. John's estimate of the eventual success of this thing was right or not, I submit that is not a matter for government or the courts or anyone else to try to pass judgment on.

And the third point I would make is that if his fellow trustees felt that this enterprise was somehow being so extravagantly managed or foolishly managed that it raised questions of their fiduciary responsibility as trustees, then they should have voted him down as trustees. That would be rather the ultimate case, Your Honor, of trustees not being responsive to a donor's wishes. And it's their ultimate recourse.

Q Now, what is your view of the trustees or directors, as they are in this instance, of a foundation to attempt to

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APPENDIX I

STATE OF WISCONSIN : CIRCUIT COURT
MILWAUKEE COUNTY

ERICA P. JOHN, as an Officer and Director of DeRANCE, INC., a Wisconsin Non-Stock, Non-Profit Corporation, et al.,	Case No. 650-555
Plaintiffs,	Testimony of TERRY LEE ZIVNEY
vs.	Afternoon Session Part II
HARRY G. JOHN, as an Officer, Director, and Trustee of DeRANCE, INC.,	
Defendant.	

July 15, 1986 Before the
HONORABLE MICHAEL J. BARRON
Circuit Judge, Branch 8,
Presiding

APPEARANCES: SMITH & O'NEIL, S.C., by
Thomas G. Cannon
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Walter F. Kelly
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For the Defendant

MR. SUTTON: Professor Terry Lee Zivney, please.

TERRY LEE ZIVNEY,
being first duly sworn on oath, testified as follows:

DIRECT EXAMINATION

BY MR. SUTTON:

Q For the record, sir, what is your name?
A Terry Lee Zivney.
Q And your age?
A Thirty-seven
Q Your address?

A University of Wisconsin, Milwaukee.
Q And what is your profession, sir?
A I'm an assistant professor of finance.
Q And would you relate your academic background commencing with your undergraduate degree? When and where did you obtain your undergraduate degree?
A I received a Bachelor of Science in electrical engineering, University of Illinois, 1971; a Master's of Business Administration from Georgia State University, 1979; and a Doctor of Philosophy in finance from Georgia State University, 1984.
Q And how long have you been employed at UWM?
A Two years.
Q And what subjects do you teach?
A I teach finance. In particular I teach investment finance.
Q And what was your dissertation for your Ph. D.?
A Title of it was "The Efficacy of Five Common Stock Selection Rules."
Q And what were the five common stock selection rules that you wrote your dissertation on?
A The five rules looked at a stock in terms of the stock's price-earnings ratio, dividend yield, share price—

THE COURT: Excuse me—dividend—

THE WITNESS: Yield—

THE COURT: Yield?

THE WITNESS: —share price, the firm size, and its net working capital.

Q Okay, what— Would you outline what subjects you teach at UWM—the names.
A I teach courses in investments at both the undergraduate and the graduate level. The courses are entitled "Investments," "Investment Finance," and "Theory of Securities Markets." The courses are roughly similar. They deal with theory and practice in investing in a wide variety of investments, stocks, bonds, options, commodities.
Q You teach at both the graduate and the undergraduate level?

Q Do you have an opinion, to a reasonable degree of certainty in the field of finance, as to whether or not the common law—common stock investments of DeRance as invested and managed by First Wilshire were prudent?

A Yes, I do. I believe they were prudent.

Q Okay. And your understanding— Would you explain what the doctrine of prudence is with respect to the application to investments by foundations or investment—or endowment funds.

MR. THOMAS CANNON: Well, I'm going to object, Your Honor, to the extent that that question calls for a legal conclusion and ask that counsel rephrase it to prudence from an economic standpoint rather than prudence from a fiduciary standpoint.

MR. SUTTON: I'm talking about from an economic and financial basis.

MR. THOMAS CANNON: Okay.

MR. SUTTON: I don't know if there's any difference between that and a fiduciary duty, but this trial ultimately will determine that.

THE COURT: Okay, you may testify, sir.

A The moder theory of finance, which focuses on the power of diversification to reduce and control risk, basically holds that an efficient portfolio, that is, in some sense an optimal portfolio, would contain some piece of every possible investment in the world. In that context that might include bankrupt firms, it might include investing in gold. Virtually all investment textbooks nowadays specifically say that investment—

MR. THOMAS CANNON: Excuse me, I'm going to object to what textbooks say.

THE COURT: Just testify from opinions, sir, as to—rather than as to what you have read.

THE WITNESS: Yes, sir.

A The concept in a nutshell holds that all assets are owned by someone, and everyone owns all the assets in aggregate. Therefore, it is reasonable that an investor would want to own part of everything. Now, practically, this is difficult. Most of us don't have the wherewithal

to buy a piece of everything. In particular, we observe that even large institutional investors may not buy a piece of everything. However, large institutional investors also hire frequently more than one investment manager with the idea that each investment manager might invest in a different segment of the market.

Furthermore, to the extent that one could view the entire family, if you will, of charities, in partcular Catholic charities, as being—having one common goal, that is, to further the Catholic faith, you might consider in some sense God as being the portfolio manager of the manager of this entire amount of charities that has dished out to a number of portfolio managers some of the assets for management. Therefore, it would not be unusual for some of those managers to choose different investment vehicles than others, and, in fact, in that grand global context it would be extremely imprudent if they all invested in the same set of stocks or the same set of assets. They would not be getting maximum benefit from the power of diversification. Therefore, it would be quite prudent for at least some foundation or some set of foundations to invest in assets that in and of themselves might be considered risky because when diversified across the entire set of foundations with similar goals and purposes, the risk of the overall venture would be minimized.

Q Now, considering the ultimate investment portfolio of DeRance as of October 5, 1984, to consist of the Fund E portfolio, the seven to eight-million-dollar investment in gold futures, the fifty to seventy-million-dollar investment in the television venture, and the three million dollar investment in sea salvage operations, do you have an opinion, to a reasonable certainty in the field of finance, as to whether or not those holdings, as a totality, were prudent for the foundation?

A Yes, I believe that those—

MR. THOMAS CANNON: I'm going to object, Your Honor, on the grounds that this witness is not qualified as an expert in television or communications investments, nor is he an expert in—qualified as an expert in deep sea

treasure hunts or in any of the other investments—nonstock investments—that the foundation was in.

THE COURT: Well, I don't think this gentleman's giving an opinion here as being an expert in TV ventures or deep sea ventures. I believe his opinion here concerns the element of diversification rather than a particular venture that DeRance and Santa Fe got involved in.

Is that correct, sir?

THE WITNESS: Yes.

THE COURT: All right.

Q What is your opinion?

A My opinion is that those investments could be considered prudent. The cash flows from each of those ventures, no matter what the ventures were, would increase the diversification.

Q Now, in your opinion, to a reasonable certainty in the field of finance, are the investment aims of the foundation determined by— By what are the investment aims of the foundation determined?

A The investment aims of the foundation were set forth in the articles of incorporation for the foundation.

Q What do you understand those aims to be?

A The aims were to provide funds to further the educational and religious purposes of the foundation.

Q And do you have an opinion, to a reasonable certainty in the field of finance, whether the entire investment portfolio, so to speak, of the foundation as of October 5, 1984, advanced the aims and comported with the investment aims of the foundation?

A Yes, I believe it did.

MR. THOMAS CANNON: I object to that, Your Honor, on the grounds that it calls for speculation beyond the competence of this witness. He's not an expert in charities at all.

THE COURT: This one I've got to draw the line on, Mr. Sutton. This man may know everything about finance, but now we're talking about foundations, and we're talking about what the aims of foundations are. Anyway, that's something for me to draw a conclusion

MR. SUTTON: Well, he can argue that. I don't believe it is.

THE WITNESS: It's comparing apples and apples.

THE COURT: He is going to be— I want to make sure I understand. You're asking him to compare the original contract with Morgan, Olmstead—

MR. SUTTON: The objectives.

THE COURT: —with what was testified to by Mr. Kenny.

MR. SUTTON: Right. As to the objectives of Merrill Lynch when they handled the portfolio for the second administration to show you what the difference was.

THE COURT: All right. He can give us that. Just so we understand what the ground rules are.

A The original agreement with Morgan, Olmstead provided that the objective of Fund E was capital growth. The testimony of Mr. Kenny was that the objective of the Merrill Lynch portfolio was current income and stability or principal. I considered these to be two totally different approaches, and, therfore, two totally different portfolios would be appropriate.

Q So, given those objectives, there's nothing inconsistent with the way that Morgan, Olmstead and ultimately First Wilshire managed the fund while they had it and Merrill Lynch when they managed the fund when they had it; is that correct?

A That is true.

Q Now, there's been testimony in the plaintiffs' case, Mr. Bolduc and others, about the supposed impropriety of unsecured loans made through various entities by DeRance over the years, including the television venture, including for a professor at Cardinal Newman College with respect to other colleges. Is there— Do you have an opinion, to a reasonable degree of certainty in the field of finance, whether the—such loans—were imprudent?

MR. SUTTON: Your Honor, he's giving an opinion as an expert in finance. Well, their claims are that it was imprudent as a business practice for the foundation to make

on rather than a witness.

Q Now, you have reviewed the investment advisory agreements between the foundation and First Wilshire and the foundation and Merrill Lynch after the change in administrations?

A I have reviewed the original investments agreement between the foundation and Morgan, Olmstead, and I have read the testimony of the Merrill Lynch manager as to what he understood his directive to be from the foundation, but I have not read the agreement between the foundation and Merrill Lynch asset management.

Q Well, what difference is there between those investment aims as they were expressed?

A In managing—

MR. THOMAS CANNON: Wait a minute. I'm going to object, Your Honor, on the grounds that the question called for a comparison between First Wilshire and Merrill Lynch, and the witness has testified to Morgan, Olmstead, Kennedy and Merrill Lynch.

THE COURT: I'm not sure what the question was, but I do know he said he did not read the management contract that DeRance had with Merrill Lynch. A little hard to compare something if you haven't read it.

Q Do you have a basis for comparison in your opinion?

A I believe that the manager from Merrill Lynch told the truth, and assuming he did, there is a difference between the charters that they were given.

Q And what's that difference?

A The agreement was—

MR. THOMAS CANNON: Again, excuse me, I'm going to object on the grounds that he's comparing an investment advisory agreement for First Wilshire with the testimony of Mr. Kenny concerning statements that he was told by DeRance with respect to investment aims, and I think that it's entirely immaterial to make such a comparison.

MR. SUTTON: It goes only to the weight.

MR. THOMAS CANNON: It's comparing apples and oranges.

loans in all of these areas, and I will make an offer of proof he's going to testify it's not only imprudent, it's part and parcel the fabric of American business to operate in that fashion, from the indicia of credit cards all the way through the largest transactions in the corporate system.

THE COURT: Well, before you suggest that it be in the form of an offer of proof, let me make a ruling first.

MR. SUTTON: Oh, okay.

THE COURT: If it's only in the field of finance, I believe this gentleman can testify. As long as it's confined to that, I have no problems—because I agree with Mr. Cannon that there's been no testimony whatsoever that this gentleman ever examined all of the transactions that went on between DeRance and all the various different people and/or organizations that were left money.

Q So, with that limitation, understanding of loans that you are aware of, what is your opinion?

A My understanding, based partly on Mr. Cannon's questioning at my deposition, were that these loans were unsecured. Unsecured loans are a part of the fabric of American business. The vast majority of business loans run secure. The vast majority of new debt capital raised ~~in~~ this country is by debentures, which by definition are unsecured loans. Accounts receivable, which form a very substantial proportion of the financing of American business, are virtually all unsecured. Credit cards are unsecured. It is not unheard of for people to make unsecured loans with the expectation that they may be repaid.

Q Now, there has been evidence introduced that at some time during the period between 1977 and 1984 an attorney for the foundation served on the board of directors of some companies in which the foundation held a position through its investments in Fund E. In your opinion, to a reasonable degree of certainty in the field of finance, is there anything unsuitable or erroneous about that?

MR. THOMAS CANNON: Well, again, Your Honor, I'm going to object on the grounds that this witness is

not an expert in ethics. And, in fact, he testified two weeks ago that he was not an expert in ethics.

MR. SUTTON: Your Honor, this constant reference to what he testified two weeks ago is totally inappropriate. If he wants to cross-examination him on

definition of front running. You don't have to be an expert in enforcement of security laws to give a definition of what that is. You may have a proper objection later, but I'm not sure, but certainly not on a definition.

Go ahead, sir.

A Front running is defined as purchasing a security in one market shortly before purchasing a similar or related security in another market, relying upon the market forces in the first market affecting the price in the second market, and, therefore, profiting from this private information.

Q Okay. You have considered and reviewed the materials that were presented by the plaintiffs with respect to the allegation that Mr. John was engaged in front running with respect to certain trades in this common stock market, have you not?

A Yes, I have.

Q Now, what are your observations with respect to the application of the front-running doctrine to those transaction in this particular case?

MR. THOMAS CANNON: I'm going to object, Your Honor, on the grounds of competency.

THE COURT: Overruled.

You may answer.

MR. THOMAS CANNON: Your Honor, then I'd like to object on the grounds that counsel's question is not to the degree of—and standard required by the code of evidence for an opinion.

Q To a degree of certainty in the area of finance?

A I believe there is insufficient evidence to indicate there was front-running. In fact, viewing the exhibits that were presented, I would say there was significant evidence that First Wilshire, as the manager of the foundation and

Harry John's accounts, was quite fair in apportioning the stock between the two. In particular, I reviewed Exhibit—I believe it was 347—that showed the matched transactions. In this exhibit there were forty-four such transactions. Twenty-three times out of the forty-four the foundation was first into the market, that is, very close to fifty percent of the time, which is what the expected value is if First Wilshire alternated giving chances to securities to their various clients, which would be a fair thing to do.

Q And when two entities, both purchase a stock, what is your opinion about whether it's possible for those purchases to take place so simultaneously that neither one nor the other purchases in advance of the other?

MR. THOMAS CANNON: I'm going to object, Your Honor, to the form of the question on the grounds that possibility is not the appropriate evidentiary standard.

MR. SUTTON: The probability.

THE COURT: Well, rephrase the question so we make sure we got it correct.

MR. SUTTON: Well, I'll rephrase the question.

Q How is the concept of front running from the standpoint of the time differential between the trades of the two entities usually defined?

A The general situation where people are concerned in front running, the time between the trades is a matter of minutes, that is, insufficient time for the participants in the ohter markets to learn of the previous transaction. Certainly, it would be less than 15 minutes because the tape to the public is delayed only 15 minutes, and, therefore, it's a public knowledge even on Milwaukee television stations as to what the transaction prices were.

Q And the information that you reviewed—what evidence, if any, was there of any trades that took place within minutes or hours?

A Without actually looking at the exhibit, I cannot say there were none that took place on the same day. However, I do recall that most of them took place weeks or months apart.

Q Now, the experts for the plaintiffs have also testified that the portfolio of Mr. John was enriched by the later entry into the—or purchase of stock in companies by the foundation. What is your opinion, to a reasonable degree of certainty in the area of finance, whether the evidence supports that conclusion?

A I saw no evidence that Mr. John's portfolio benefited directly as a result of the foundation's portfolio.

Q Now, what is your opinion with respect to the variables that control the appreciation of the value of a stock—vis-avis that the one aspect of a pruchase of a large amount of that stock, by in this case, the foundation?

A In all cases, of course, prices in the market are set by supply and demand. To be more specific, however, as to specific factors which influence prices of blocks of stock, numerous academic studies have been performed on the effect of block trading on the price of stock. These studies show—

MR. THOMAS CANNON: I'm going to object, your Honor, as to what any studies show as hearsay.

THE COURT: You can give your opinion.

A My opinion is—

THE COURT: Based on those studies.

THE WITNESS: Sure.

A My opinion, based on those studies, is that there is little to no permanent impact upon the price of the stock based upon block trades.

Q Now, there's evidence introduced by the plaintiffs that they conclude—their experts finally conclude—of some matched trading of stock sales by Mr. John and purchases by the foundation of certain stocks in the same companies in the same volume. You know what I'm relating to—3500 sharess of some lighting company sold by Mr. John's portfolio on one day and the same day 3500 shares being purchased by the DeRance Foundation, and the conclusion, after all of that by the plaintiff's experts, was that the foundation was purchasing the same stock that Mr. John sold. What is your opinion, to a degree of certainty in the area of finance, whether that conclusion

is valid?

A My conclusion is that the—there is a very real possibility that those were not the same shares of stock.

Q Why is that, Professor Zivney? How does the stock market operate?

MR. THOMAS CANNON: I'm going to object, Your Honor, again and move that that last answer be stricken on the grounds that the witness is testifying to possibility, not probability.

MR. SUTTON: No, he's attacking their

used the phrase "possibility" in the context of his explanation. The fact that he uses that term doesn't invalidate his testimony and his explanation. It doesn't make it inadmissable.

THE COURT: I may be wrong, Mr. Sutton, but I don't think I ever heard him say that that is not a valid conclusion.

MR. SUTTON: You're right. He didn't respond directly to my question.

BY MR. SUTTON:

Q What is your opinion, to a reasonable degree of certainty in the area of finance, whether their conclusions are valid about those being the same stock certificates or shares?

A Since there is another explanation which fits all the facts that they presented, I would have to say that there were other valid conclusions that could be drawn that were equally as valid as theirs.

Q And is one of those valid conclusions that it was not a cross-trade?

A One of the possible conclusions, possible valid conclusions, would be that they were not the same shares of stock.

Q Why is that?

MR. THOMAS CANNON: Your Honor, I'm going to

STATE OF WISCONSIN : CIRCUIT COURT
MILWAUKEE COUNTY

ERICA P. JOHN, as an Officer and Director of DeRANCE, INC., a Wisconsin Non-Stock, Non-Profit Corporation, et al.,	Case No. 650-555
Plaintiffs,	Testimony of TERRY LEE ZIVNEY and DIRK WAGNER
vs.	
HARRY G. JOHN, as an Officer, Director, and Trustee of DeRANCE, INC.,	
Defendant.	

July 16, 1986 Before the
HONORABLE MICHAEL J. BARRON
Circuit Judge, Branch 8,
Presiding

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EXHIBITS

Number	Description	Marked	Offered	Received
1561	Fund E Evaluation	110	128	129
1562	Fund E Evaluation	110	128	129
1563	Fund E Evaluation	110	128	129
1564	Fund E Evaluation	110	128	129
1565	Fund E Evaluation	110	128	129
1566	Fund E Evaluation	110	128	129
1567	Fund E Evaluation	110	128	129
1092	Copy of newspaper article	165	166	167

management of foundation portfolios, and what's appropriate for some other kind of portfolio I don't think is relevant or material here.

THE COURT: It's overruled. Any alleged deficiencies on the part of this witness to give an opinion in the field in which you mention would be a question

for weight rather than admissibility.

Q My question is do you have an opinion, to a reasonable degree of certainty in investment finance, whether or not the assets of the DeRance Foundation between 1977 and October 5, 1984, were managed in a prudent fashion by Mr. John to the extent that he was involved in the management of those assets?

A Yes, I have an opinion.

Q What is your opinion?

A My opinion is that the evidence I have seen indicates that it was managed prudently.

Q Now, is your study of investments limited to the stock market?

A No, sir.

Q What kind of investments are considered in addition to the stock market in the financial theory?

A In financial theory, we are interested in all assets, that is, stocks, bonds, options, futures, real estate, any—any type of investment for which money changes hands or which has a potential cash flow which is within the purview of the study of finance.

Q Now, to turn for a moment to the cross trades, I direct your attention to the conclusions of Mr. Sims, and do you recall what Mr. Sims' purported expertise was?

A He stated he was an expert in the area of quantitative methods.

Q Now, that is an area that you have also studied?

A Yes, sir.

Q Do you have an opinion on the validity of Mr. Sims' conclusion that the evidence presented to him showed that it was mathematically impossible for the trades to have been other than between Mr. John and the foundation?

A Yes, my opinion is that is an invalid conclusion because it doesn't take into account all the—all of the evidence that should have been taken into account.

Q And what evidence was not considered by Mr. Sims that you believe is important to reach a conclusion one way or the other on that?

A Mr. Sims had obviously not considered the possibility or the role of market makers and specialists in securities markets.

Q And their role to the extent—in what respect—in what particulars?

A In particular, specialists in market makers maintain and sell from inventories. Therefore, as I testified previously, it is not certain that they were the same shares that were bought and sold by Mr. John and the foundation.

Q And from the information that has been submitted to you, can you, with any definiteness, determine whether or not the trades that have been introduced are—occurred directly—or, strike directly—occurred between Mr. John and the foundation?

A I have seen no evidence that they did.

Q And do you have an opinion, to a reasonable degree of certainty in the field of investment finance, whether in the ultimate conclusion of whether there was cross trading or self-dealing, the knowledge of Mr. John with respect to the transactions is of any significance?

MR. THOMAS CANNON: I'm going to object, Your Honor, on the grounds this question is beyond the competence of this witness. Clearly not an expert in self-dealing, has no background in that at all. Also calls for a legal conclusion.

THE COURT: You may answer it.

A My understanding is that Mr. John's account with First Wilshire was a discretionary account.

Q And what do you understand— What is the meaning of discretionary account in the field of investment finance?

A Discretionary account means that the manager makes the decisions about what to buy and sell, basically has a power of attorney to perform these transactions on behalf of the client.

Q Okay. Now, continue. What does that have to do with Mr. John's knowledge?

A Well, in a discretionary account, one of the reasons that investors give a manager discretionary account is they have perhaps neither the time nor the expertise to follow

their account on a moment-to-moment basis, and they pay an expert manager to perform that function for them. Therefore, frequently, the client will only receive statements from time to time showing the profits or losses in his account, and presuming that it's profitable that a client probably sticks with the manager and says, Keep at it, boy.

Q All right. And so what would the significance of Mr. John's knowledge have on whether there was self-dealing?

A I would conclude that Mr. John, in a discretionary account, almost certainly would not be directing the trades. It would not be a discretionary account in that case. Therefore, I would conclude that any self-dealing was done by the Manager, if indeed it occurred at all.

MR. THOMAS CANNON: Going to object, Your Honor, on the grounds it calls for a legal conclusion.

MR. SUTTON: I don't want a legal conclusion. I want a conclusion based on the basis in the field of investment finance.

MR. THOMAS CANNON: Your Honor, he's also testified he doesn't have enough information on this to have an opinion.

MR. SUTTON: No, he doesn't have enough information to determine whether one or the other outperformed. But he just testified that on the information he does have, it would be so insignificant as to—there is no outperformance.

THE COURT: Objection is overruled. As long as it does not relate to legal conclusions, but rather opinions in the field of investment finance.

A My understanding from reading the investment literature is that the term "scalping" refers to the activities where a manager buys stock for his own account before he buys stock for the account of his clients. That is the definition that I run across in the literature. Since Mr. John was not the manager of the account for DeRance, it would have been impossible to them to have scalped. He was not the manager.

Q Now, do you consider the influence of the taxes on investments in your teaching and research?

A Yes, I do.

Q In your opinion, to a reasonable degree of certainty in the area of investment finance, how did Harry John's creation of the foundation increase the money available to give to charity?

A The creation of the foundation increased the amount of money to be given to charities. There were basically two ways that Harry John could have given his money for charitable works. He would have given it out of his own pocket, basically after taxes, or he could give the money to the foundation and have the foundation give the money to the same charitable activities before taxes. Obviously, over a long period of time, the appreciation accumulating tax free in a foundation would be considerably larger than that that would be available out of his own pockets after a tax—

MR. THOMAS CANNON: Excuse me, professor, excuse me. I'm going to move to strike this whole answer, Your Honor, as totally immaterial and irrelevant. We're faced with the fact that Mr. John created this foundation in 1946, and to try and opine on what would have happened in the event that he had given it out have his pocket as opposed to starting the foundation some 40 years ago is totally immaterial and